CLERK'S COPY:

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1940

No. 55

DONALD S. McCLAIN, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 15, 1940.

CERTIORARI GRANTED MAY 20, 1940.

SUPREME COURT OF THE UNITED STATES

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COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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TRANSCRIPT OF RECORD.

UNITED STATES CIRCUIT COURT OF APPEALS,
FIFTH CIRCUIT.

DONALD S. McCLAIN,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition to Review the Decision of the United States Board of Tax Appeals.

DOCKET ENTRIES.

Donald S. McClain, Petitioner,
vs. Docket No. 92705.
Commissioner of Internal Revenue, Respondent.

Appearances.

For Petitioner:
M. E. Kilpatrick, Esq.,
Harold Hirsch, Esq.,
Marion Smith, Esq.

1938.

Mar. 25—Petition received and filed. Taxpayer notified. (Fee paid.)
Mar. 25—Copy of petition served on General Counsel.
May 6—Answer filed by General Counsel.
May 6—Request for Circuit hearing in Atlanta, Georgia, filed by General Counsel.
May 16—Notice issued placing proceeding on Atlanta Calendar. Answer and request served.
Dec. 7—Hearing set Feb. 20, 1939, Atlanta, Georgia.

1939.

Feb. 20—Hearing had before Mr. Disney on merits. Submitted. Stipulation of facts filed. Petitioner's brief due 3/10/39—respondent's brief due 4/1/39—reply due 4/10/39.

Mar. 6—Transcript of hearing 2/20/39 filed.

Mar. 10—Brief filed by taxpayer. 3/10/39 copy served.

Apr. 5—Motion for leave to file brief filed by General Counsel—brief lodged. 4/6/39 granted.

Apr. 13—Reply brief filed by taxpayer. 4/13/39 copy served.

June 22—Supplemental brief lodged by taxpayer.

June 28—Motion for leave to file supplemental brief filed by taxpayer. 6/29/39 granted.

June 30—Copy of motion and brief served on General Counsel.

Aug. 30—Memorandum opinion rendered—John E. Murdock, Division 3. Decision will be entered for the respondent.

Sept. 5—Decision entered—J. E. Murdock, Division 3.

Nov. 18—Supersedeas bond in the amount of $2,068.50 approved and ordered filed.

Nov. 18—Petition for review by U. S. Circuit Court of Appeals, Fifth Circuit, with assignments of error filed by taxpayer.

Nov. 24—Proof of service filed by taxpayer.

Nov. 18—Praecipe for record filed by taxpayer.

Nov. 24—Proof of service of praecipe filed.

2 PETITION.

Received Mar. 25, 1938.

Filed Mar. 25, 1938.

(Title Omitted.)

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IT:C:2-CLW-90D) dated February 16, 1938, and as a basis of his proceeding alleges as follows:

1.

Petitioner is an individual, with residence at 20 Cherokee Road, (outside City) Atlanta, Georgia.

2.

The notice of deficiency, a copy of which is hereto attached as a part hereof and marked "Exhibit A," was mailed to petitioner on February 16, 1938.

3.

The taxes in controversy are income taxes for the year 1935. The entire deficiency of $1,034.25 deter-
3 mined by the respondent is in controversy.

4.

The determination of tax set forth in the said notice of deficiency is based upon the following errors hereby assigned to the determination of the respondent:

(a) In determining that $15,000 face value of bonds of Cameron County Water Improvement District Number Two, Cameron County, Texas, owned by petitioner, were retired in 1935.

(b) In disallowing the bad debt of $7,523.25 claimed by petitioner as a deduction in his return for the year 1935, and being on account of determination in said year by petitioner of uncollectibility to the extent of $7,523.25 on $15,000 of bonds of Cameron County Water Improvement District Number Two, Cameron County, Texas.

(c) In limiting to 30% by application of Section 117 (f) of the Revenue Act of 1934, the deduction of $7,523.25, representing a bad debt in connection with ownership of said bonds aforesaid, and in failing to deduct any portion of $7,523.25 in the computation of deficiency.

4 (d) In determining that Section 117 (f) of the Revenue Act of 1934 was applicable, and in applying said section to the bad debt of $7,523.25 determined by petitioner in 1935, and in failing to allow any deduction by reason thereof in the computation of the deficiency.

(e) In increasing the taxable net income of petitioner by $7,523.25 by disallowance of bad debt of said amount.

(f) In determining a deficiency of $1,034.25 for said year.

(g) In disallowing compensation of $661.20 paid the Bankers Trust Company, a trustee, who managed properties of petitioner during the year 1935, said compensation representing necessary expense in the preservation of said

properties and the collection of the income therefrom during 1935.

5.

The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) As determined by the Commissioner in the ninety-day letter aforesaid, petitioner received as a gift $15,000 par value of Cameron County Water Improvement District Number Two, Cameron County, Texas, bonds in 1918, at a time when the bonds had a value of $15,000.

5 (b) In 1935, petitioner received $7,476.75 from the Cameron County Water Improvement District Number Two Cameron County, Texas, as a partial payment on said bonds. Just prior to said payment the said District had sought the benefits of the Municipal Bankruptcy Act of Congress, whereupon the Act was declared unconstitutional by the Supreme Court of the United State. Thereupon, the said District made application for a refunding loan from the Reconstruction Finance Corporation, which was granted in an amount sufficient to enable the District to pay 49.9¢ on the dollar on the bonds held by petitioner and others.

(c) On information and belief that said Cameron County Water Improvement District Number Two, Cameron County, Texas, at the date of payment in 1935 of the amount aforesaid, executed to the Reconstruction Finance Corporation a mortgage or loan deed or other conveyance to secure payment of the loan obtained by it from the Reconstruction Finance Corporation.

(d) On information and belief that the Reconstruction Finance Corporation at said time made a survey, or had

a survey made, and determined that the said District could pay only 49.9¢ on the dollar of all of the
6 bonded indebtedness owed by it.

(e) That during the year 1935 conditions in said District were very bad and landowners and taxpayers alike were unable to pay their taxes and the said District was in default on both the principal and interest on said bonds.

(f) That petitioner determined the difference, $7,523.25, between the amount paid to petitioner by the District as aforesaid, namely, 49.9¢ on the dollar, or $7,476.75, and the amount of said bonds, $15,000, as being uncollectible, and this determination was made by petitioner in the year 1935.

(g) That petitioner, on his records, charged off the said bad debt during the year 1935.

(h) The expense of $661.20 paid to Bankers Trust Company was for services of said Company in the management and investment and reinvestment of property of petitioner held by said Trust Company as Trustee. The said expense was a necessary expense for the proper maintenance and preservation of petitioner's property, and likewise was an ordinary and necessary expense in the collection of the income and profits from such property.

7 Wherefore, petitioner prays that the Board may hear this proceeding and determine that there is no deficiency due from petitioner for the year 1935.

M. E. KILPATRICK,
HAROLD HIRSCH &
MARION SMITH,
Counsel for Petitioner.

1045 Hurt Building,
Atlanta, Georgia.

EXHIBIT "A".

Treasury Department,
Washington.

Feb. 16, 1938.

Office of Commissioner of Internal Revenue.

Address Reply to
Commissioner of Internal Revenue,
And Refer to

Mr. Donald S. McClain,
28 Cherokee Road, (Outside city),
Atlanta, Georgia.

Sir:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1935, discloses a deficiency of $1,034.25 as shown in the statement attached.

In accordance with section 272(a) of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C1:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period

terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
GUY T. HELVERING,
Commissioner,
By CHAS. T. RUSSELL,
Deputy Commissioner.

Enclosures:
Statement.
Form 870.

9 STATEMENT.

IT:C:2
CLW-90D.

Mr. Donald S. McClain,
28 Cherokee Road,
(Outside city),
Atlanta, Georgia.

Tax Liability for Taxable Year Ended December 31, 1935.

	Liability	Assessed	Deficiency
Income Tax	$1,507.49	$473.24	$1,034.25

In making this determination of your income tax liability, careful consideration has been given to the internal revenue agent's report dated January 25, 1937; to your protest dated March 22, 1937, and to the statements made at the conference held July 22, 1937, in the office of the internal revenue agent in charge at Atlanta, Georgia, and that held December 16, 1937, in this office.

A copy of this letter and statement has been mailed to your representative, Mr. Martin E. Kilpatrick, 1045 Hurt Building, Atlanta, Georgia, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Adjustments to Net Income.

Taxable Year Ended December 31, 1935.

Net income as disclosed by return	$14,263.79
Unallowable deductions and additional income:	
(a) Trustee's fees	661.20
(b) Bad debts	7,523.25
Net income adjusted	$22,448.24

Explanation of Adjustments.

(a) This item represents trustee's fees paid in connection with a revocable trust of which you are the sole beneficiary, the income of which is taxable to you and was reported in line 5 of your return.

10 Under article 166(c) of Regulations 86, the deductions allowable to the trust, the income of which is taxable to the grantor, are the same as would have been allowable had there been no trust. This article is amended by Treasury Decision #4629 published in Cumulative Bulletin XV-1, June, 1936, page 140; see section (d) of the decision on page 142, which is to the same effect as section 166(c). Since this trust was established for your personal convenience, the fees paid do not constitute an ordinary and necessary business expense, and are disallowed.

(b) The item $7,523.25 claimed on the return as a bad debt is found to represent the difference between the value of bonds of Cameron County Water Improvement District No. 2, Cameron County, Texas, at the time they were received as a gift from your father in 1918, $15,000.00, and the amount you received upon their retirement in 1935, or $7,476.75. It appears that this corporation was far in arrears in payment of principal and interest on the bonds, and that it attempted to take advantage of the Municipal Bankruptcy Act, but when this act was declared unconstitutional it made application for a refunding loan from the Reconstruction Finance Corporation. After careful consideration the loan was granted in an amount which enabled the corporation to retire its bonds at 49.9 cents on the dollar. You are advised that the Revenue Act of 1934 in providing for limitation of losses to be allowed as a deduction on returns, specifically includes amounts received on retirement of bonds. Section 117(f) of that act reads as follows:

"Retirement of bonds, etc.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidence of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form shall be considered as amounts received in exchange therefor."

It, therefore, appears that the item can not be treated as a bad debt under the statute, since the portion quoted provides that it shall be treated otherwise. Section 117 applies to sales or exchanges of property, and as indicated in the part quoted, it is not intended to be limited solely to voluntary sales between a willing buyer and a willing seller.

11 A pertinent ruling is found in Income Tax 2986 published in Cumulative Bulletin XV-1, June, 1936, page 136, as follows:

"Where the M Improvement District refunded its bonds prior to maturity with the intention of not reissuing them, losses sustained by the holders thereof are subject to the limitation contained in section 117(a) and (d) of the Revenue Act of 1934, unless the bonds were not held as 'capital assets' as defined in the Act."

Since section 117 also places a $2,000.00 limitation on the amount of losses allowable, and that amount has already been allowed, no further loss may be allowed on this item.

Computation of Tax.

Taxable Year Ended December 31, 1935.

Net income adjusted		$22,148.24
Less:		
Personal exemption	$2,500.00	
Credit for dependents	800.00	3,300.00
Balance (Surtax net income)		$19,148.24
Less:		
Interest on Liberty bonds	1,873.46	
Dividends	7,994.37	
Earned income credit	300.00	10,167.83
Net income subject to normal tax		$ 8,980.41
Normal tax at 4% on $8,980.41		359.22
Surtax on $19,148.24 (amount in excess of $4,000.00)		1,149.27
Total tax		$ 1,508.49

Less:	
Income tax paid at source	1.00
Correct income tax liability	$ 1,507.49
Income tax assessed:	
Original, account #80730	473.24
Deficiency	$ 1,034.25

12 State of Georgia,
County of Fulton.

Before me, the undersigned attesting officer, personally appeared Donald S. McClain, who being duly sworn on oath says that he is the petitioner in the within and foregoing petition; that he has read the said petition and that the facts stated therein are true.

DONALD S. McCLAIN.

Sworn to and subscribed before me, the 22 day of March, 1938.

LUCILLE DAY,
Notary Public.

Notary Public, Georgia, State at Large. My Commission expires Sept. 18, 1940.

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13 ANSWER.

Received May 6, 1938.

Filed May 6, 1938.

(Title Omitted.)

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel,

Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in Paragraph 1 of the petition.

2. Admits the allegations contained in Paragraph 2 of the petition.

3. Admits the allegations contained in Paragraph 3 of the petition.

4(a) to (g), inclusive. Denies that the Commissioner committed errors as alleged in sub-paragraphs (a) to (g), inclusive, of Paragraph 4 of the petition.

5(a). Admits the allegations contained in sub-paragraph (a) of Paragraph 5 of the petition.

(b). Admits that in 1935 the petitioner received $7,476.75 from the Cameron County Water Iimprovement District Number Two, Cameron County, Texas, but alleges that said amount was received in retirement of said bonds and not as partial payment thereon. Admits the remaining allegations contained in sub-paragraph (b) of
14 Paragraph 5 of the petition.

(c) to (h), inclusive. Denies the allegations contained in sub-paragraphs (c) to (h), inclusive, of Paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and that the petitioner's appeal be denied.

(Signed) J. P. WENCHEL, GWK.
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
HARRY R. HORROW,
Special Attorney,
Bureau of Internal Revenue.

HRH/vm 5-5-38.

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15 STIPULATION OF AGREED FACTS.

Filed at Hearing Feb. 20, 1939.

(Title Omitted.)

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective counsel of record, that the following facts are true and that same may be so taken, and considered by the Board as offered in evidence by the parties to this proceeding; provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

1.

The petitioner, Donald S. McClain, a citizen of the United States, residing in Atlanta, Georgia, received, by gift from his father in 1918, $15,000.00 par value of Cameron County

Water Improvement District Number Two, Cameron County, Texas, Bonds, at a time when the bonds had a value of $15,000.00.

2.

Said Cameron County Water Improvement District Number Two, Cameron County, Texas, was and is a political subdivision or branch of the State Government of Texas.

3.

In 1935, the petitioner received from said District on the principal of said bonds the sum of $7,476.75, this amount being made under the following circum-
16 stances:

(a) Just prior to said payment the said District, being unable to pay the interest or principal of its bonds, had sought the benefits of the Municipal Bankruptcy Act of Congress, whereupon the Act was declared unconstitutional by the Supreme Court of the United States. Thereupon, the said District made application to the Reconstruction Finance Corporation for a refunding loan, which the Reconstruction Finance Corporation granted in an amount sufficient to enable the District to pay 49.9¢ per dollar on the principal of the bonds held by petitioner and others; that is to say, all Cameron County Water Improvement District Number Two bondholders received 49.9¢ per dollar on the principal of its bonds from the proceeds of the loan obtained by said District from the Reconstruction Finance Corporation.

(b) At the time that the loan was obtained by the said District from the Reconstruction Finance Corporation in 1935 conditions had become very bad in Texas, land owners or taxpayers in said District being unable to pay their

taxes and the District was in default on both the principal and interest on its bonds, including the bonds held by petitioner. The Reconstruction Finance Corporation made a survey in 1935 just prior to the making of the loan and determined that 49.9¢ on the dollar of the principal was the maximum amount the taxpayer could stand, in addition to current liabilities and charges, and conse-
17 quently that was the extent of the loan made by the Reconstruction Finance Corporation.

(c) Upon making of application to the Reconstruction Finance Corporation by the District, the Corporation sent an appraiser to Cameron County, Texas, who examined the property in the District and the financial condition of the District and of the taxpayers in the District. The application to the Reconstruction Finance Corporation by the District was for a loan of $300,000.00, but after the appraisal aforesaid the Reconstruction Finance Corporation Board passed a resolution on January 6, 1935, authorizing a loan secured by the assets of the District not to exceed $264,500.00 to the District. In authorizing the loan, the Reconstruction Finance Corporation imposed the following conditions:

"*Deposit of Old Securities.* The holders of Old Securities who join in this plan of refinancing shall deposit the same with one or more committees, depositaries, or other responsible representatives satisfactory to them, which shall consent to the plan of refinancing contemplated by this resolution (hereinafter referred to as 'Owners' Agents'), or shall otherwise give this Corporation satisfactory assurances that the Old Securities held by them will be subjected to such plan, in which latter case they are hereinafter referred to as 'consenting owners.' Old Securities deposited with Owners' Agents or held by consenting owners are hereinafter referred to as 'Deposited Securities.' Each Owners' Agent shall be duly authorized to receive

all moneys payable to the holders of Old Securities deposited with it, to surrender the Deposited Securities and do all other acts and things necessary to enable the
18 District to effect a reduction in its indebtedness to the extent and in the manner contemplated by this resolution.

"No loan shall be made hereunder (a) unless all of the Old Securities shall be thus deposited or (b) unless the Division Chief shall deem that such a large proportion of such securities has been deposited as will satisfactorily accomplish the purposes of this Corporation in authorizing this loan. In this latter event, as hereinafter more fully provided, lesser amounts may be payable on the Deposited Securities than in case all of the Old Securities are deposited."

(d) As a result of its appraisal in 1935 the Reconstruction Finance Corporation determined that the said District was then unable to pay the full indebtedness as represented by the bonds held by petitioner and others, and that the extent of the ability of said District to pay its bonds was limited to the said amount which the Reconstruction Finance Corporation lent to said District. In fact, said District in 1935 became financially unable to pay the principal or interest on its bonds except to the extent of 49.9¢ on the dollar of the principal of its bonds.

(e) The bonds of face value $15,000.00 held for profit but not in connection with his trade or business by the petitioner, who consented to the plan of refinancing, were forwarded to a bank in Texas, and upon receipt of 49.9¢ on the dollar the said bonds were delivered over to the bank as agent for the District to be canceled.

19 (f) It was the understanding of petitioner and all other bondholders in so surrendering their

bonds that the amount of 49.9¢ on the dollar so received on account of the principal was the final and only amount which he would receive on the said bonds, although there was no writing to evidence this nor any agreement between the District and the bondholders to that effect.

4.

On his books during the year 1935, the petitioner wrote off as uncollectible the difference between $15,000.00, the value of the bonds at the date of gift to him, and the amount received from the District, namely, $7,476.75, the difference being $7,523.25, which difference petitioner in 1935 determined was uncollectible, and on his income tax return for 1935 petitioner took as a deduction this amount of $7,523.25 as a bed debt.

5.

The respondent determined that the amount received by the petitioner from the District as aforesaid during 1935 constituted a retirement of the bonds and, under the provisions of Section 117 of the Revenue Act of 1934, the respondent limited the said loss of $7,523.25 to $2,000.00. The taxes involved are income taxes for the calendar year 1935 in the amount of $1,034.25.

6.

During the year 1935, petitioner paid to the Bankers Trust Company for services of said company in the management, investment and reinvestment of property held by said Trust Company as Trustee for petitioner, the sum of $616.20. The said payment was made in accordance with the provisions of the trust instrument creating the Trust based upon a percentage of the net income of the Trust. The Trust in question is a

revocable one of which the petitioner is both the grantor and the sole beneficiary. The income from the Trust is taxable to the petitioner and was so reported on his 1935 tax return. The duties of the Trust Company as Trustee under the said deed of trust included the complete management of the trust property, the trust instrument giving the Trust Company full power to manage, invest and reinvest and to convert the property. The Trust Company held all of the securities and made all collections of income and exercised full discretion with reference to matters of investment.

(Sgd.) M. E. KILPATRICK,
Attorney for Petitioner.

(Sgd.) J. P. WENCHEL, SLY.
Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent.

SBA.
WAS-afh 8-31-38.

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21 MEMORANDUM OPINION.

United States Board of Tax Appeals.

Donald S. McClain, Petitioner,
vs. Docket No. 92705.
Commissioner of Internal Revenue, Respondent.

M. E. Kilpatrick, Esq., for the petitioner.

Stanley B. Anderson, Esq., for the respondent.

MURDOCK:

The Commissioner determined a deficiency of $1034.25 in the petitioner's income tax for 1935. Two issues are

presented for decision, first, whether the petitioner's loss from an investment in bonds was a bad debt or a capital loss, and, second, whether he is entitled to a deduction for a fee paid to the trustee of a revocable trust. The facts are found as stipulated.

The petitioner acquired some Water Improvement District bonds in 1918 which had a basis to him for gain or loss of $15,000. The District was unable to pay the interest and principal on its bonds in 1935 and applied to the Reconstruction Finance Corporation for a loan. The loan was granted in an amount sufficient to enable the District to pay $.499 per dollar upon its bonds and upon condition that all or a sufficient amount of the bonds would be deposited and committed to the plan of refinancing the District. The petitioner deposited his bonds, the plan was carried out, and the petitioner received $7,476.75 in cancellation of his bonds in 1935. That was the entire amount which he was entitled to receive. The record does not show what became of the difference of $8.25. The petitioner charged off the balance of his basis as a bad debt and claimed the amount as a bad debt deduction upon his return for 1935. The Commissioner, in determining the deficiency, held that the surrender of the bonds constituted a retirement thereof within section 117(f) of the Revenue Act of 1934 and limited the deduction from the loss to $2,000 under section 117(d).

22

The Commissioner was right. See *S. C. Thompson*, 40 B. T. A. 60, where the Board considered this same question and decided it adversely to the contention of this particular taxpayer. See also *Austin Corbin, 2nd*, 39 B. T. A. 1163.

The petitioner paid $616.20 in 1935 to a bank for its services as trustee in managing, investing and reinvesting the corpus of a revocable trust established by the petitioner and of which he is the sole beneficiary. The fee was paid in accordance with the deed of trust. The income of the trust is taxable to and was reported by the

petitioner. The bank exercised complete control in managing the fund.

The petitioner claims that he is entitled to de-
23 duct the $616.20 upon the facts stipulated. His argument is that he is engaged in the trade or business of managing his own estate and, had he not paid the fee to the trustee, he would have incurred expenses of "bookkeeping, etc." in approximately the same amount. The facts do not show that the petitioner was engaged in any trade or business. Neither do they show that the fee was other than a personal expense of the petitioner paid for his own convenience. It is not deductible under section 23. Cf. *Kane v. Commissioner*, 100 Fed. (2d) 382, affirming 34 B. T. A. 1200.

Decision will be entered for the respondent.

Enter: Entered Aug. 30, 1939.

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24 DECISION.

United States Board of Tax Appeals,
Washington.

Donald S. McClain, Petitioner,
vs. Docket No. 92705.
Commissioner of Internal Revenue, Respondent.

Pursuant to the determination of the Board, as set forth in its Memorandum Opinion entered August 30, 1939, it is Ordered and Decided: That there is a deficiency in income tax for the year 1935 in the amount of $1,034.25.

(Signed) J. E. MURDOCK,
(Seal) Member.

Enter: Entered Sept. 5, 1939.

25 Received Nov. 16, 1939.

Filed Nov. 18, 1939.

(Title Omitted.)

To the Honorable Judges of the United States Circuit Court of Appeals for the Fifth Circuit:

The petitioner in support of his petition filed in pursuance of Section 642, Title 28 of U. S. C. A. petitioning for review of the decision of the United States Board of Tax Appeals rendered on the thirtieth day of August, 1939, wherein the said Board of Tax Appeals approved a deficiency in the income tax of the petitioner in the amount of $1,034.25 for the calendar year 1935, respectfully shows to the Honorable Court as follows:

1. Statement of the Nature of the Controversy.

The controversy herein involved arises by virtue of the Commissioner of Internal Revenue having assessed a deficiency against petitioner in the amount of $1,034.25 for income taxes for the calendar year 1935. The Commissioner of Internal Revenue in determining said
26 deficiency disallowed to the petitioner a deduction claimed by the petitioner in his income tax return for the year 1935 for a bad debt in the amount of $7,476.75. The disputed item arose by virtue of the loss by reason of uncollectibility of Water Improvement District Bonds of the Cameron Water Improvement District No. 2. The said district became financially embarrassed and paid only 49.9 per cent of the face value of its obligations. The remaining 50.1 per cent was determined to be uncollectible and was charged off as a bad debt in 1935. The Commissioner of Internal Revenue determined that the loss suffered by the petitioner was suffered by reason of a retirement of said bonds pursuant to Section 117 (f)

of the Revenue Act of 1934 and limited the deduction of the taxpayer to the amount of $2,000 pursuant to Section 117 (d) of said Revenue Act. The taxpayer's intention was and is that said bonds became uncollectible to the amount of $7,476.75 within the year 1935 and that said amount was properly charged off by him in said year as a bad debt pursuant to Section 23 (k) Revenue Act of 1934.

II. Designation of Court of Review.

The petitioner is aggrieved by said decision of the Board of Tax Appeals herein and seeks a review thereof in accordance with the provisions of the law in such cases pertaining. The United States Circuit Court of Appeals for the Fifth Circuit has jurisdiction on this con-
27 troversy by reason of Section 641 of Title 26 of U. S. C. A. The petitioner is an individual residing within the State of Georgia. He filed his income tax return for the year 1935 in the office of the Collector of Internal Revenue in Atlanta, Georgia.

III. Assignments of Error.

The petitioner as a basis for review makes the following assignments of error:

1. The conclusion of the Board of Tax Appeals that petitioner suffered a capital loss under Section 117 (d) of the Revenue Act of 1934 when he received partial payment on the bonds of the Water Improvement District No. 2, Cameron County, Texas, at the rate of 49.9 per cent is an erroneous conclusion. Petitioner assigns error thereon.

2. The conclusion of the Board of Tax Appeals that the Water Improvement District No. 2, Cameron County, Texas, retired its bonds within the meaning of Section 117 (f) of the Revenue Act of 1934 by making a payment on principal at the rate of 49.9 per cent is an erroneous conclusion. Petitioner assigns error thereon.

3. The conclusion of the Board of Tax Appeals that petitioner was not entitled to a deduction for a bad debt under Section 23 (k) of the Revenue Act of 1934 to the extent that the bonds of Water Improvement District No. 2, Cameron County, Texas, were determined to be worthless and charged off by the petitioner in the year 1935 is an erroneous conclusion. Petitioner assigns error thereon.

4. The action of the Board of Tax Appeals in entering a decision ordering and deciding that there was a deficiency in the income tax of the petitioner for the year 1935 in the amount of $1,034.25 was erroneous. Petitioner assigns error thereon.

Wherefore, your petitioner prays that this Honorable Court may review such findings, decisions and opinion and order and reverse and set aside the same and that the Clerk of the United States Board of Tax Appeals be directed to transmit and deliver to the Clerk of this Court certified copies of all and every document necessary and material to the prosecution and conclusion of the foregoing petition for review and as required by the rules of said Court and statutes made and provided.

HIRSCH, SMITH & KILPATRICK,
M. E. KILPATRICK,
E. D. SMITH, JR.,
Attorneys for Petitioner.

Georgia,
Fulton County.

M. E. Kilpatrick, being duly sworn on oath, says: That he is counsel of record in the above entitled cause; that as such counsel he is authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the statements contained therein and that the statements made are true to the best of his knowledge, information and belief.

M. E. KILPATRICK.

Sworn to and subscribed before me this 14 day of November, 1939.

CAROLINE HANES,
Notary Public.

Received Nov. 24, 1939.

Filed Nov. 24, 1939.

(Title Omitted.)

To J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue:

You are hereby notified that on the 18th day of Nov., 1939, Donald S. McClain, through his attorneys, did file with the Clerk of the United States Board of Tax Appeals of Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Fifth Circuit of the decision of the Board heretofore rendered in the above entitled cause. A copy of the petitioner for review and the assignments of error as filed is attached and served upon you.

This .... day of November, 1939.

HIRSCH, SMITH & KILPATRICK,
M. E. KILPATRICK,
E. D. SMITH, JR.,
Attorneys for Appellant.

Personal service of the foregoing notice, together with a copy of the petition for review and assignments
31 of error mentioned therein is hereby acknowledged.

This 18th day of November, 1939.

J. P. WENCHEL,
Counsel for Respondent.

---

32 PRAECIPE.

Received Nov. 16, 1939.

Filed Nov. 18, 1939.

(Title Omitted.)

To the Clerk of the United States Board of Tax Appeals:

You are requested by the petitioner to make a transcript of the record to be filed in the United States Circuit Court of Appeals for the Fifth Circuit pursuant to review taken in the above entitled cause and to include in such transcript of record copies, duly certified as correct, the following documents:

1. The docket entries of proceedings before the Board.

2. All pleadings before the Board.

a. Petition for redetermination.

b. Answer of Commissioner of Internal Revenue.

3. Stipulation of facts filed in said proceeding.

4. Memorandum opinion of the Board of Tax Appeals in said petition.

33 5. Order of redetermination entered in said cause.

6. Petition for review, notice of filing thereof with proof of service.

7. This praecipe.

The foregoing to be prepared, certified and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Fifth Circuit.

HIRSCH, SMITH & KILPATRICK,
M. E. KILPATRICK,
E. D. SMITH, JR.,
Attorneys for Appellant.

34 CERTIFICATE.

United States Board of Tax Appeals,
Washington.

Donald S. McClain, Petitioner,
vs. Docket No. 92705.
Commissioner of Internal Revenue, Respondent.

I, B. D. GAMBLE, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 33, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In Testimony Whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 1st day of Dec., 1939.

B. D. GAMBLE,
(Seal) Clerk, United States Board of Tax Appeals.

[fol. 29] That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz.:

ARGUMENT AND SUBMISSION

Extract from the Minutes of March 12th, 1940

No. 9370

DONALD S. McCLAIN,

versus

COMMISSIONER OF INTERNAL REVENUE

On this day this cause was called, and, after argument by M. E. Kilpatrick, Esq., for petitioner, and F. E. Youngman, Esq., Special Assistant to the Attorney General, for respondent, was submitted to the Court.

[fol. 30] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 9370

DONALD S. McCLAIN, Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent

Petition for Review of Decision of United States Board of Tax Appeals (District of Georgia)

OPINION OF THE COURT—Filed March 23, 1940

Before Sibley, Hutcheson and Holmes, Circuit Judges

SIBLEY, Circuit Judge:

Having owned for seven years $15,000 par value of Cameron County Water Improvement District coupon bonds, in 1935 the taxpayer accepted from the District for them $7,476.75, and in his tax return claimed a deduction of $7,523.25 as for a bad debt charged off. The Board of

Tax Appeals upheld the Commissioner in his ruling that the [fol. 31] loss was not a bad debt under Sect. 23 (k) of the Revenue Act of 1934, but fell under a new provision, Sect. 117 (f) of that Act whereby the loss on the bonds was to be treated as a capital loss. This is the sole question here.

Section 117 deals with capital gains and losses, which are "recognized upon the sale or exchange of a capital asset." Prior to 1934, a corporate bond note or other evidence of debt, when it proved bad in whole or in part, could be charged off as a bad debt. Only if sold or exchanged could it be treated as a capital asset. Sect. 117 (f), put into the Revenue Act of 1934, reads thus: "For the purposes of this title amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof) with interest coupons or in registered form, shall be considered as amounts received in exchange therefor." 26 U. S. C. A. Sect. 101 (f). The corporate paper described as registered or bearing coupons is intended for long time investment. The effect of the provision is to make the retirement of it by the maker equivalent for tax purposes to a sale of it to another, and the necessary consequence is that it falls under the capital assets provisions of Sect. 117 (a) and (d), and if it has been held more than a year a loss cannot be taken into account at 100 per cent, and the limitation of capital net losses to $2,000 will apply. Such was the treatment given this loss.

Whether it is correct depends on the meaning of the word "retirement". The Century Dictionary defines "retire" as "to recover, redeem, regain by the payment of a sum of money", and this definition was given judicial approval as applied to a note in Empire Security Co. vs. Berry, 211 Ill. App. 278. Webster's International Dictionary gives, among [fol. 32] other meanings, "to withdraw from circulation, or from the market; to take up and pay, as to retire bonds, to retire a note." The agreed facts about these coupon bonds are these: The District had sought municipal bankruptcy in vain. See Ashton vs. Cameron County District, 298 U. S. 513. It could not collect its taxes and was in default on both principal and interest of its bonds. In order to readjust its indebtedness it applied for a loan to Reconstruction Finance Corporation, which would agree to lend only enough to pay 49.9% of the principal of the bonds. To obtain that all the

bondholders were required to deposit their bonds with a committee with authority "to receive all monies payable to the holders of old securities deposited with it, to surrender deposited securities, and do all other acts necessary to enable the District to effect a reduction in its indebtedness to the extent and in the manner contemplated by this resolution." The bonds of the taxpayer were forwarded to a bank in Texas and on receipt of 49.9% were delivered to the agent of the District to be cancelled. It was understood by the taxpayer and all other bondholders in so surrendering their bonds that the 49.9% received was final, though there was no writing to evidence such agreement between the District and bondholders. We hold that the deposit of the bonds for surrender and their surrender for cancellation on payment by the District of the agreed sum was a retirement of them. If there had been simply a payment of 49.9% on the bonds, they being still held as an obligation good or bad, it would be otherwise. No writing of release was necessary. The surrender and cancellation of the bonds withdrew them from circulation forever, and retired them. What was received must under the statute be treated as the [fol. 33] proceeds of a sale of the bonds. There was no bad debt left to be charged off. The loss on account of the bonds was correctly considered a capital loss.

Affirmed.

[fol. 34] JUDGMENT

Extract From the Minutes of March 23rd, 1940

No. 9370

DONALD S. MCCLAIN

versus

COMMISSIONER OF INTERNAL REVENUE

This cause came on to be heard on the petition of Donald S. McClain for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court, that the decision of the said United States Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

[fol. 35] MOTION AND ORDER STAYING MANDATE—Filed April 1, 1940

IN THE UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT

No. 9370

DONALD S. McCLAIN, Appellant,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent

MOTION FOR ORDER WITHHOLDING MANDATE

Now comes Donald S. McClain, appellant in the above entitled cause, and moves this Honorable Court to withhold the issuance of its mandate in the above entitled cause for a period of sixty days from and after the date of the order thereon for the purpose of enabling appellant to prepare and file in the Supreme Court of the United States a petition for certiorari.

(Signed Hirsch, Smith & Kilpatrick, (Signed) E. D. Smith, Jr., Attorneys for Appellant.

[fol. 36] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH DISTRICT

No. 9370

DONALD S. McCLAIN, Appellant,

versus

COMMISSIONER OF INTERNAL REVENUE, Appellee

On Consideration of the Application of the petitioner in the above numbered and entitled cause for a stay of the mandate of this court therein, to enable petitioner to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, it is Ordered that the issue of the mandate of this court in said cause be and the same is stayed for a period of thirty days; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within thirty days from the date of this

order there shall be filed with the clerk of this court the certificate of the clerk of the Supreme Court that certiorari petition, and record have been filed, and that due proof of service of notice thereof under Paragraph 3 of Rule 38 of the Supreme Court has been given. It is further ordered that the clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of thirty days from the date of this order, unless the above-mentioned certificate shall be filed with the clerk of this court within that time.

Done at New Orleans, La., this 1st day of April, 1940.

(Signed) Rufus E. Foster, United States Circuit Judge.

[fol. 37] CLERK'S CERTIFICATE

UNITED STATES OF AMERICA:

UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 29 to 36 next preceding this certificate contain full, true and complete copies of all the pleadings, record entries and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 9370, wherein Donald S. McClain is petitioner, and Commissioner of Internal Revenue is respondent, as full, true and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 28 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 1st day of April, A. D. 1940.

Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals, Fifth Circuit. (Seal.)

[fol. 38] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed May 20, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted, and the case is assigned for argument immediately following No. 895.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

179

CLERK'S COPY.

402,709
Sup. Ct

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 58

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

S. C. THOMSON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 25, 1940
CERTIORARI GRANTED MAY 20, 1940

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 58

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

S. C. THOMSON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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238324—40——1

1 Before United States Board of Tax Appeals

Docket No. 91308

S. C. THOMSON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket entries

Appearances: For Petitioner: T. F. Davies Haines, Esq. For Respondent: J. C. Maddox, Esq.

1937

Nov. 13—Petition received and filed. Taxpayer notified. (Fee paid.)

Nov. 13—Copy of petition served on General Counsel.

Dec. 14—Answer filed by General Counsel.

Dec. 21—Notice issued placing proceeding on New York City Calendar. Copy of answer served on taxpayer.

1938

Oct. 25—Hearing set beginning Nov. 28, 1938, in New York City.

Nov. 28—Hearing had before Mr. Murdock on the merits. Proceeding submitted on stipulation of facts. Stipulation of facts filed. Taxpayer's brief due Dec. 28, 1938. Respondent's brief due Jan. 27, 1939. Taxpayer's reply due Feb. 11, 1939.

Dec. 12—Transcript of hearing 11/28/38 filed.

Dec. 17—Notice of appearance of Allen G. Gartner as counsel for taxpayer filed.

2 Dec. 21—Brief filed by taxpayer. 12/21/38 copy served.

1939

Jan. 27—Brief filed by General Counsel.

Feb. 10—Reply brief filed by taxpayer. 2/10/39 copy served.

June 7—Opinion rendered—John E. Murdock, Division 3. Decision will be entered for the respondent.

June 14—Decision entered—J. E. Murdock, Division 3.

June 26—Motion for reconsideration and amendment of findings of fact filed by taxpayer.

June 28—Motion denied.

Aug. 5—Notice of the withdrawal of Allen G. Gartner filed.

Aug. 9—Petition for review by U. S. Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.

Aug. 9—Proof of service filed.

Aug. 9—Notice of the appearance of T. F. Davies Haines as counsel filed.

1939

Aug. 9—Notice of the withdrawal of E. I. Sproull as counsel filed.
Aug. 12—Praecipe for record filed by taxpayer with proof of service thereon.

3 Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed Nov. 13, 1937

The above named petitioner hereby petitions for a reduction for a redetermination of the deficiency set forth by the respondent in his notice of deficiency, symbols IT:A:1-GCF:90D, dated October 6, 1937, and as a basis of this proceeding alleges as follows:

1. The petitioner is an individual residing at 2 E. 61st Street, New York, New York.

2. The notice of deficiency (copy of which is attached and marked Exhibit "A") was mailed on or about October 6, 1937.

3. The taxes in controversy are income taxes for the calendar year 1934, and in the amount of $4,641.02.

4. The petitioner alleges the following errors made by the respondent in the determination of tax set forth in said notice of deficiency:

(a) The respondent erred in disallowing a deduction for bad debts of $24,625.00, represening the difference between the cost of bonds of New York United Hotels, Incorporated, and the amount received in settlement pursuant to court order.

5. The petitioner sets forth the following facts upon which he relies as the basis of this proceeding:

4 (a-1) On May 25, 1927, the petitioner purchased bonds of the New York United Hotels, Inc., 6% due February 1, 1947, and having a par value of $25,000.00, at a cost of $24,750.00.

(a-2) Due to the insolvency of the company, receivership proceedings were instituted in the United States District Court for the Southern District of New York.

(a-3) As a result of the reorganization of the company, and at the direction of the court, the petitioner received on or about June 23, 1934, $5.00 in full settlement of each $1,000.00 bond, or a total of $125.00.

Wherefore, the petitioner prays that the Board may hear the proceeding and find that there is no deficiency in tax due from the petitioner for the year 1934, giving and granting such other and further relief to which the petitioner may be justly and legally entitled.

(Signed) EDWARD I. SPROULL,
Edward I. Sproull,
Counsel for Petitioner,
17 East 42nd Street, New York, New York.

[*Duly sworn to by A. C. Thomson; jurat omitted in printing.*]

5 *Exhibit A to petition*

OCTOBER 6, 1937.

IT:A:1.
GCF–90D.
MR. S. C. THOMSON,
29 Broadway, New York, New York.

SIR: You are advised that the determination of your income-tax liability for the taxable year (s) ended December 31, 1934, discloses a deficiency of $4,641.02, as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C1:P–7. The signing and filing of this form will expedite the closing of your return (s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By (Signed) W. T. SHERWOOD,
Acting Deputy Commissioner.

Enclosures:
Statement.
Form 870.
GCF/LM–3.

6 *Statement*

IT:A:1.
GCF–90D.

In re: Mr. S. C. Thomson, 29 Broadway, New York, New York

Tax Liability for Taxable Year Ended December 31, 1934

Income tax, liability $5,025.28; assessed, $384.26; deficiency, $4,641.02.

The deficiency shown herein is based upon the report of Internal Revenue Agent Walter A. Laine, dated June 29, 1936, and upon such adjustments as are set forth herein.

Careful consideration has been accorded your protests dated September 15, 1936, and April 5, 1937, in connection with the findings of the examining officer, and the information submitted at conferences

held in the office of the Internal Revenue agent in charge, and in this office.

As a result of your protest and the above-mentioned conferences, dividends have been decreased by $157.13. However, your contention with respect to the New York United Hotels, Incorporated, loss has not been conceded.

Net income reported	$12,140.78
Add: 1. Loss disallowed	24,625.00
Total	36,765.78
7 Deduct: 2. Dividends decreased	157.13
Net income adjusted	$36,608.65

Explanation of Changes

1. The loss of $24,625.00 represents the difference between the cost of New York United Hotels, Incorporated, bonds in the amount of $24,750.00 and the amount of $125.00 received in settlement therefor. This transaction is considered as an exchange under the provision of section 117 (f) of the Revenue Act of 1934, subject to the limitations imposed by that section. Since other transactions in securities result in a loss in excess of $2,000.00 no amount is allowed with respect to the aforementioned bonds.

2. Dividends have been decreased by $157.13 representing the non-taxable portions of dividends paid by Kennecott Copper Corporation and New Jersey Zinc Corporation.

Computation of Tax

Net Income adjusted		$36,608.65
Less:		
Dividends	$17,696.97	
Earned income credit on $3,000.00	300.00	17,996.97
Income subject to normal tax		$18,611.68
Normal tax at 4% on $18,611.68		744.47
Surtax on $36,608.65		4,347.81
Total Tax		$5,092.28
8 Less: Tax paid at source		67.00
Income tax liability		$5,025.28
Income tax assessed: Account #812847		364.26
Deficiency		$4,661.02

A copy of this letter has been mailed to your representative, Mr. Edward I. Sproull, 17 East 42nd Street, New York, New York, in accordance with the authority contained in the power of attorney on file with the Bureau.

GCF/Lm-3.

Before United States Board of Tax Appeals

[Title omitted.]

Answer

Filed Dec. 14, 1937

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in Paragraph 1 of the petition.
2. Admits the allegations contained in Paragraph 2 of the petition.
3. Admits the allegations contained in Paragraph 3 of the petition.
4–(a). Denies that the respondent erred as alleged in Paragraph 4–(a) of the petition.
5. Denies the allegations of fact contained in Paragraph 5 of the petition and all sub-paragraphs thereof.
6. Denies generally and specifically each and every allegation contained in the petition and not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the appeal be denied.

(Signed) J. P. WENCHEL,
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
CHESTER A. GWINN,
ARTHUR W. CARNDUFF,
Special Attorneys,
Bureau of Internal Revenue.

10 Before United States Board of Tax Appeals

S. C. THOMSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 91308. Promulgated June 7, 1939

Where the receivers of a corporation, pursuant to a court order in the receivership proceedings, paid to the debenture holders who surrendered their debentures before a fixed time a nominal sum in full payment and settlement of the debentures, there was a "retirement" of the debentures within the meaning of that word as used by Congress in section 117 (f) of the Revenue Act of 1934.

E. I. Sproull, C. P. A., for the petitioner.
James C. Maddox, Esq., for the respondent.

Opinion

MURDOCK: The Commissioner determined a deficiency of $4,641.02 in the income tax of the petitioner for the calendar year 1934. The only issue for decision by the Board is whether a loss of $24,625 is a capital loss, as determined by the Commissioner, or whether it was deductible in 1934 as a bad debt. The Board adopts as its findings of fact the stipulation filed by the parties.

The petitioner purchased $25,000 face amount of 20-year 6 per cent sinking-fund, gold debentures of the New York United Hotels, Inc., maturing February 1, 1947. He purchased the bonds in May 1927 at a cost of $24,750. The bonds were subject to redemption by the debtor at any time after notice of 30 days, but if they were redeemed before maturity, they had to be redeemed at a premium.

11 The debtor encountered financial difficulties beginning in 1931 and the bondholders at that time waived a portion of the interest on the bonds. Ancillary receivers were appointed by a Federal court on December 15, 1933, at which time a plan to reorganize the debtor corporation was submitted to the court. The plan proposed a sale of the assets of the corporation to a new corporation and permitted the debenture holders to purchase for cash debentures to be issued by the new corporation upon certain terms. A supplemental plan was submitted to the court in February 1934 making minor changes in the original plan. The court, on March 8, 1934, entered an order approving the plan, but under that plan there was no provision for debenture holders who did not participate in the plan of reorganization. The court entered its final order on May 22, 1934, under which the receivers were directed, inter alia, to pay to debenture holders who would surrender their debentures with all coupons attached before a fixed time, $5 for each $1,000 face amount. The petitioner received a written notice pursuant to the order of the court of May 22, 1934, which stated that the debtor corporation's assets had been sold and that he was entitled to receive $5 for each $1,000 face amount of his debentures upon surrender of the debentures, with all interest coupons attached, on or before August 20, 1934. Payment of $5 was to be "in full payment and settlement of said debentures." The petitioner surrendered his debentures on June 22, 1934, and received $125 in cash for them.

The Commissioner, in determining the deficiency, allowed the deduction of losses from sales or exchanges of capital assets arising from transactions, other than the one involved in these bonds, in an amount which exceeded the gains from such sales or exchanges by at least $2,000.

Section 117 (d) of the Revenue Act of 1934 provides that losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges.

12 Thus, if the Commissioner was correct in determining that the petitioner's loss from the disposition of the bonds was a capital loss, the loss will not benefit the petitioner for income tax

purposes. The petitioner, therefore, seeks to have this loss allowed as a bad debt under section 23 (k). The petitioner kept no books, but made his return upon a cash basis and claimed the loss in question as a bad debt on his return for 1934. Bonds are evidences of debt and such debts may give rise to a deduction under section 23 (k). Samuel Bird, 4 B. T. A. 259; Merrill Trust Co., 21 B. T. A. 1395; Carl P. Dennett, 30 B. T. A. 49; Commonwealth Federal Savings Bank v. Lucas, 41 Fed. (2d) 111; Kitselman v. Commissioner, 89 Fed. (2d) 458; certiorari denied, 302 U. S. 709; Pacific National Bank of Seattle v. Commissioner, 91 Fed. (2d) 103. The Commissioner contends, however, that section 117 (f) is controlling. That provision, which appeared for the first time in the Revenue Act of 1934, is as follows:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * * * *

(f) Retirement of Bonds, Etc.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

The petitioner argues that the provision is not applicable because the word "retirement" was intended to mean redemption at maturity, or at some earlier time, in accordance with the terms of the debentures, and was not intended to include such a forced surrender of the bonds as occurred in this case for a nominal amount in obvious violation of the redemption provisions of the bonds.

13 The word "retirement" is not defined in the statute. It is susceptible of various meanings. Among the meanings given in Webster's New International Dictionary are these: "To withdraw from circulation or from the market, to take up or pay, as to retire bonds, or retire a note." The same authority defines "redeem" as meaning "to pay back, to recover the obligation of, or to fulfill as a promise." No case has come to our attention where a court has considered the possible distinction, from the standpoint of retirement, between a forced surrender of bonds for an amount less than that provided in the debentures, as opposed to a redemption of bonds for full value in accordance with the provisions of the bonds governing redemption. Although the provisions of section 117 (f) clearly apply where bonds have been retired in accordance with their redemption provisions (cf. Fairbanks v. United States —U. S.— [3/27/39]), there may be room for doubt as to whether the provisions apply when bondholders are forced to surrender their bonds for less than the redemption figure.

The legislative history of the provision has been examined in an effort to discover the intent of Congress. The capital gain and loss provisions first appeared in the Revenue Act of 1921. A capital

gain or loss was defined in that statute, and also in later statutes, as the gain or loss resulting from the "sale or exchange" of capital assets. The question of whether the redemption of a capital asset bond was a sale or exchange had arisen. There are decisions holding that it is not a sale or exchange. Fairbanks v. United States, supra; Arthur E. Braun, Trustee, 29 B. T. A. 1161; John H. Watson, Jr., 27 B. T. A. 463. The effect of such holdings in the case of a loss might be favorable to the Commissioner, but the effect in the case of a gain might be favorable to the taxpayer. The first suggestions to Congress for eliminating uncertainty on this subject were presented in the hearings before the Committee on Ways and Means while it was considering the Revenue Bill of 1928.

14 Recommendations were made to that committee that capital gain and loss in the Revenue Bill of 1928 should be defined as including any gain or loss resulting from "redemption or retirement of corporate securities." A suggestion from another source was that the term "sale" should be defined to include all transactions resulting in taxable gain or loss. The purpose was to avoid confusion and prevent litigation. A brief submitted to the Finance Committee during the hearings on the Revenue Bill of 1928 also recommended that the capital gain and loss provisions be clarified to show that gain or loss from the "redemption or retirement of corporate securities constitutes 'capital gain.'" The argument was that if corporate securities had been held for more than two years, the tax result should be the same whether they were sold, retired, or redeemed. Congress did not adopt the suggestions for the purpose of the Revenue Act of 1928.

This same subject was brought to the attention of the Committee on Ways and Means considering the Revenue Bill of 1934, and again the contention was made that the question ought to be settled by a clarifying provision. The suggestion was that capital gain or loss be defined as resulting from the "sale, exchange, or redemption of capital assets." The only reference to this subject in the Committee reports is the following from the report of the Ways and Means Committee: "Subsection (f) provides that amounts received upon the retirement of corporate bonds and similar evidences of indebtedness shall be considered as amounts received in exchange therefor." Congress has not disclosed why it did not use the suggested word "redemption" but selected instead the word "retirement."

The word "retirement" as applied to evidences of indebtedness has a somewhat broader meaning than the word "redemption." Retirement is generally understood as meaning to withdraw from circulation not necessarily in accordance with the redemption pro-

15 visions of the bonds, whereas redemption is generally understood to mean a retirement in fulfillment of or in accordance with the provisions for redemption contained in the indenture. Thus, the selection by Congress of the word "retirement" and the rejection of the word "redemption" would seem to indicate an intent on the

part of Congress to give breadth to subsection (f). The suggestions to Congress for a change were prompted by a desire on the part of the Bar for an end to uncertainty and the resulting litigation, and Congress, in enacting the legislation, was apparently attempting to bring about the desired result. That desired result could be best accomplished by including in capital gains and losses, gains and losses from all transactions in bonds giving rise to taxable gain or loss. It seems reasonable to believe that Congress intended the word "retirement" to have its broadest meaning. An inference might be drawn from the evidence in the present case that the bondholders had lost all of their equity in the property of the debtor and the $5 was given to them as a sop. If that was not the situation, another inference would be that they were practically forced to surrender their bonds. Certainly, they did not have much choice in the matter. An argument, not without force, is that the statute should not be interpreted as applying in case of a forced surrender or in case of a mere nominal payment in discharge of the bonds. However, it would be extremely difficult to draw any satisfactory line for the purposes of section 117 (f) short of applying the section to all retirements. The bonds in the present case were retired in the sense that they were withdrawn from circulation, taken up on behalf of the debtor, and discharged as an obligation. We hold that there was a retirement of these bonds within the meaning of that word as used by Congress in section 117 (f). The question of ascertainment of worthlessness of the debt and whether that ascertainment should have been made in an earlier year are questions which need not be considered in view of this holding.

Decision will be entered for the respondent.

16 Before United States Board of Tax Appeals, Washington

Docket No. 91308

S. C. THOMPSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

Pursuant to the determination of the Board, as set forth in its report promulgated June 7, 1939, it is

Ordered and Decided: That there is a deficiency in income tax for the calendar year 1934 in the amount of $4,641.02.

Entered June 14, 1939.

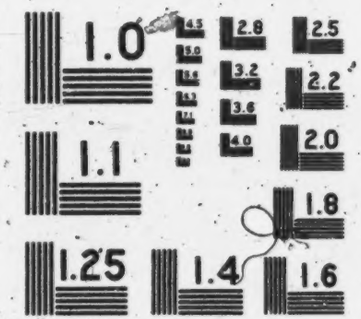
[SEAL] (Signed) J. E. MURDOCK,
Member.

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CARD 2





17 Before United States Board of Tax Appeals

[Title omitted.]

Petition for review

Filed Aug. 9, 1939

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

I

JURISDICTION

Petitioner Samuel C. Thomson is a citizen of the United States residing in New York City. He petitions this Court to review the decision of the United States Board of Tax Appeals entered June 14, 1939, finding a deficiency in his income tax for the calendar year 1934 in the amount of $4,641.02. The income-tax return in respect of which the foregoing tax liability arose was filed by petitioner with the Collector of Internal Revenue for the Second District of New York whose office is located in New York City and is within the jurisdiction of this Court.

18

II

NATURE OF CONTROVERSY

In 1927 petitioner purchased $25,000 face amount of New York United Hotels, Inc., 20-Year Sinking Fund Gold Debentures maturing February 1, 1947. Petitioner held these debentures until June, 1934, prior to which time the debtor corporation had gone into receivership, receivers having been appointed in December 1933. On March 8, 1934, Judge Coxe of the United States District Court, Southern District of New York, signed an order approving a reorganization plan for the debtor corporation and confirming a sale of its assets pursuant to the plan. Under the plan petitioner was entitled to purchase for cash at par debentures of a new corporation known as Hotel Roosevelt, Inc., in the ratio of $10 face value of new debentures for each $1,000 face value of the debtor's debentures, and upon such purchase he was entitled to receive in addition for each $1,000 face value of the debtor's debentures five shares of preferred stock and a voting trust certificate for five shares of common stock of the new corporation. If he did not subscribe to the new debentures but assented to the plan, he could have received upon surrender of the old debentures a voting trust certificate for common stock of the new corporation in the ratio of 2½ shares for each $1,000 debenture of the debtor. Petitioner chose neither alternative and refused his assent to the plan. On May 22, 1934, Judge Coxe signed an order

winding up the receivership. This order provided, among other things, that nonassenting debenture holders and certain general creditors of the debtor should receive from the new corporation in full satisfaction of their claims against the debtor $5.00 in cash for each $1,000 debenture of the old company or each $1,000 of allowed creditors' claims. On June 22, 1934, petitioner, pursuant to
19 the foregoing order, surrendered his debentures to Hotel Roosevelt, Inc., the new corporation, and received $125 cash.

Petitioner in his 1934 income tax return claimed, as a bad debt deduction, the sum of $24,625, which represented the difference between the cost to him in 1927 of $25,000 face value New York United Hotels, Inc., debentures and the amount he received upon the winding up of the receivership. Subsequently, on audit of the return, the Commissioner took the position, which was affirmed by the Board, that petitioner's $24,625 loss on the debentures in question did not constitute a loss arising from a bad debt but was rather a loss from sale or exchange within the meaning of Section 117 (f) of the Revenue Act of 1934. That section provides, in substance, that amounts received by the holder upon the retirement of debentures with interest coupons shall be considered as amounts received in exchange therefor. Other capital losses sustained by the petitioner in the year 1934 exceeded by more than $2,000 his capital gains for that year.

The foregoing is the primary issue on this appeal. A secondary issue is whether the Board was correct in refusing to find that petitioner sustained his loss on the foregoing debentures during the calendar year 1934.

ASSIGNMENTS OF ERROR

The Board of Tax Appeals erred:

(1) in finding that $25,000 New York United Hotels, Inc., 6% debentures owned by petitioner and surrendered by him to Roosevelt Hotel, Inc., in 1934 against a payment of $125 cash, were withdrawn from circulation, taken up on behalf of the debtor and discharged as an obligation, for the reason that such finding is unsupported by any evidence before the Board;

(2) in holding that the sum of $125 received by petitioner upon the surrender to Roosevelt Hotel, Inc., of $25,000
20 New York United Hotels, Inc., 6% debentures constituted an amount "received in exchange therefor," within the meaning of Section 117 (f) of the Revenue Act of 1934;

(3) in holding that the loss sustained by petitioner with respect to $25,000 New York United Hotels, Inc., 6% debentures did not constitute a bad debt ascertained to be worthless in the calendar year 1934 and as such deductible against petitioner's ordinary net income for that year within the meaning of Section 23 (k) of the Revenue Act of 1934; and

(4) in refusing to hold that there was no deficiency in tax due from petitioner for the year 1934.

Wherefore, petitioner respectfully asks that this Court review the decision and order of the United States Board of Tax Appeals and reverse and set aside the same and direct the said Board to find that there is no deficiency in tax due from petitioner for the year 1934, and for the entry of such further orders and directions as may by this Court be deemed necessary and proper.

T. F. DAVIES HAINES,
Attorney for Petitioner.
T. F. Davies Haines,
63 Wall Street, New York City.

21 [*Duly sworn to by T. F. Davies Haines; jurat omitted in printing.*]

22 Before United States Board of Tax Appeals

[Title omitted.]

Notice of filing petition for review

Filed Aug. 9, 1939

To: COMMISSIONER OF INTERNAL REVENUE,
Internal Revenue Building, Washington, D. C.
J. P. WENCHEL, *Esq.*,
Attorney for Respondent,
Chief Counsel, Bureau of Internal Revenue,
Internal Revenue Building, Washington, D. C.

You are hereby notified that on August 9, 1939, a petition for review by the United States Circuit Court of Appeals for the Second Circuit of the decision of the United States Board of Tax Appeals heretofore rendered in the above entitled cause, was filed with the Clerk of the Board. A copy of the petition as filed is attached hereto and served upon you.

Dated, August 9, 1939.

(Signed) T. F. DAVIES HAINES,
T. F. Davies Haines,
Attorney for Petitioner,
63 Wall Street, New York, N. Y.

Service of the foregoing notice of filing and of a copy of the petition for review is hereby acknowledged this 9th day of August 1939.

(Signed) J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

[Title omitted.]

Stipulation of facts

Certain facts pertinent to the issues involved in this proceeding are herein stipulated by the parties hereto through their respective attorneys with leave to either party to introduce other and additional evidence pertaining to the said issues.

1. The taxpayer is a resident of New York City and filed in his individual Federal income-tax return for the calendar year 1934 with the Collector of Internal Revenue for the Second District of New York.

2. The return as prepared and filed reflected gross income and deductions determined upon the cash receipts and disbursements basis.

3. The deficiency here involved arises by reason of the respondent's treatment of a transaction in 1934 involving bonds of the New York United Hotels, Incorporated, as an exchange, under the provisions of Section 117 (f) Revenue Act of 1934 and the loss sustained therefrom as a capital loss and therefore subject to the limitations imposed by that section. Petitioner denies the validity of the deficiency upon the grounds that the transaction resulted in a bad debt or an ordinary loss deductible in toto in the year 1934.

4. In May 1927, the petitioner purchased twenty-year 6-percent sinking-fund gold debentures of the New York United Hotels, Inc., maturing February 1, 1947, having a par value of $25,000.00,
24 at a cost of $24,750.00. A facsimile of one of these debentures is attached hereto, made a part hereof and designated Exhibit "A." The provisions of these debentures as contained in the indenture dated February 1, 1927, which also appear in these debentures, is attached hereto as Exhibit "A–1."

5. In 1931, the debtor corporation encountered financial difficulties and the debenture holders consented to a plan of readjustment whereby they waived the payment of a portion of the interest payable on the debentures. See Exhibit "B" describing the said plan which is attached hereto and made a part hereof in conjunction with Exhibit "A" showing the debenture holders' assent to this plan of readjustment.

6. On December 15, 1933, Ancillary receivers were appointed by the United States District Court for the Southern District of New York, and on the same date a plan of reorganization was submitted to the U. S. District Court for the Southern District of New York under the terms of which the assets of the debtor corporation were to be sold to a new corporation and the debenture holders were entitled to purchase for cash other debentures to be issued by the new cor-

poration upon stated terms and conditions. A certified copy of this plan is attached hereto, made a part hereof, and designated Exhibit C–1. A supplemental plan was submitted to the Court in February 1934, offering minor changes in the original plan (Exhibit C–2 hereto attached and made a part hereof) and on March 8, 1934, the Court entered its order approving the proposed plan of reorganization, but making no provision for debenture holders who had not participated in the plan of reorganization. Exhibit C–3 attached hereto and made a part hereof.

7. On May 22, 1934, the Court entered its final order in the reorganization proceedings wherein the receivers were directed, along with other matters, to pay to debenture holders who surrendered their debentures with all coupons attached before a fixed time, five dollars ($5.00) per each $1,000 par value. Upon the performance of the matters set forth in said order, the receivers were discharged. Exhibit D attached hereto and made a part hereof.

8. Shortly after May 26, 1934, the petitioner received written notice pursuant to the Court's order of May 22, 1934 (Exhibit D) stating in effect that the debtor corporation's assets had been sold and that he was entitled to receive five dollars per $1,000 face amount of debentures held by him upon surrender of his debentures with all interest coupons attached, by August 20, 1934, said payment to be "in full payment and settlement for said debentures." Said notice is attached hereto, made a part hereof and designated Exhibit E.

9. Pursuant to said notice, the petitioner on June 22, 1934, forwarded to the designated party his debentures of a face value of $25,000 bearing Serial Numbers M4–003–4027, inclusive, each of $1,000 par value and received a total payment of $125.00 in June 1934, representing five dollars per each $1,000 face value. Photostat of the letter of transmittal accompanying the debentures is attached hereto, made a part hereof and designated Exhibit F.

10. Losses from sales or exchanges of capital assets arising from transactions other than that involving the bonds of the New York United Hotels, Incorporated, have been allowed in the notice of deficiency dated October 6, 1937, from which this appeal is taken, in an amount of at least $2,000.00, plus gains from such sales or exchanges.

EDWARD I. SPROUL,
Counsel for Petitioner.

J. P. WENCHEL,
Chief Counsel for the Bureau of Internal Revenue,
Attorney for Respondent.

26 *Exhibit C-1 to stipulation of facts*

PLAN OF REORGANIZATION OF NEW YORK UNITED HOTELS, INC.

(THE ROOSEVELT)

Dated December 13, 1933

BURTON A. HOWE,
CHARLES DOHERTY,
JUNIUS R. JUDSON,
WILLIAM A. SMART,
Reorganization Committee.

COLONIAL TRUST COMPANY,
57 William Street, New York, N. Y., Depositary.

LOUIS A. BRUTY,
Secretary, Hotel Roosevelt,
45th Street at Madison Avenue, New York City, N. Y.

27 PLAN OF REORGANIZATION OF NEW YORK UNITED HOTELS, INC.

(THE ROOSEVELT)

PRESENT CAPITALIZATION

Twenty Year Six Per Cent. Sinking Fund Gold Debentures, due February 1, 1947; outstanding in the hands of the public, $5,113,500.00.

(There is excluded from the foregoing Debentures the face amount of $10,000 held in the treasury.)

Of the foregoing amount there has been deposited under the Plan of Readjustment, dated December 8, 1931, $4,551,500 and in addition, consents have been signed by the owners of $387,500 of the debentures which have not been actually deposited.

Preferred Stock—Seven Per Cent. Cumulative. Outstanding in the hands of the public 38,143½ shares of the par value of $100 each, or the sum of $3,814,350.00.

(This does not include 3,778½ shares held in the treasury.)

Dividends have accrued upon the foregoing Preferred stock amounting to the sum of $1,357,272.87, up to and including August 1, 1933.

Common Stock—64,710 shares of the par value of $64,710.00.

(The foregoing does not include 290 shares held in the treasury.)

28 GENERAL FACTS

The building known as The Roosevelt is constructed upon the land leased by the New York State Realty and Terminal Company, to New York United Hotels, Inc. (hereinafter termed the Corporation), which lease is dated August 1, 1922, and expires on September 1, 1943, and contains the option for two renewal terms, each of twenty-one years.

The New York State Realty and Terminal Company (hereinafter termed the Landlord), advanced toward the construction of the hotel building $3,000,000, which sum the Corporation agreed to repay as sinking fund rental under the terms of the lease. There has been paid as sinking fund rental upon account of the $3,000,000, the sum of $780,000, leaving the net amount unpaid upon such advance by the Landlord, the sum of $2,220,000 (of which sum payment of $150,000 was deferred, and payment of $300,000 is now in default.)

The lease from the Landlord to the Company required the Corporation to pay, in addition to taxes, water rents, etc., a ground rental of $23,333.33 per month, a building rental computed with reference to the interest on the unpaid balance of the $3,000,000 advanced, amounting at the present time to $12,950 per month, and on October 1st of each year a sinking-fund rental in reduction of the $3,000,000 advanced, amounting in each of the years 1931, 1932, 1933, and 1934 to $150,000 per year and for the year 1935 and for each of the subsequent years until the entire advance is repaid, $180,000 per year. Likewise the Corporation agreed to purchase its steam and electricity (when not generated by the Corporation) from the Landlord and pay monthly therefor.

On December 8, 1931, a Plan of Readjustment was promulgated by the Corporation, with the consent of the Landlord, which Plan of Readjustment provided generally as follows:

29 A—Debenture holders consenting thereto postponed the payment of the four interest coupons on their debentures, payable February 1, 1932, August 1, 1932, February 1, 1933, and August 1, 1933, until the maturity of the debentures, February 1, 1947; and

B—Accepted in lieu of the interest reserved upon the debentures, for the coupons due February 1, 1934, August 1, 1934, February 1, 1935, and August 1, 1935, one-half of the amount of the interest reserved in such coupons, and postponed payment of the remaining one-half of such interest until the maturity of the debentures, February 1, 1947; and

C—Waived the payment of that portion of the next five annual sinking fund installments applicable to the purchase of the debentures, and that portion of such sinking fund payments as represented the interest postponed as aforesaid;

D—In consideration of the consent by the debenture holders to the foregoing, the Corporation agreed that no dividends would be paid upon the Preferred or Common stock under certain restrictions; and

E—Agreed to compensate the holders of debentures agreeing to the Plan, by an income coupon not exceeding 2%, beginning with the calendar year 1936, and to create a Finance Committee representing the debenture holders and the Landlord, with veto power on all financial commitments.

Predicated upon such Plan of Readjustment, the Landlord agreed to postpone the payment of the $150,000 sinking fund rental due under the terms of the lease on October 1, 1931, so that one-tenth thereof should become due and payable October 1, 1934, and one-tenth thereof each year thereafter, and if the condition of the Company on October 1, 1932, should be such, all other obligations
30 under the lease having been provided for or paid, that the Corporation was not in sufficient funds to meet the sinking fund rental of $150,000, due on that date, to make a similar postponement; with like provisions with regard to the postponement of the sinking fund rental due on October 1, 1933.

Under the terms of such Plan of Readjustment, as hereinbefore set forth, $4,551,500 face value of debentures were duly deposited, stamped under the Plan, with the additional and changed coupons attached thereto, and in addition thereto, the holders of debentures of the face value of $387,500 consented in writing thereto, but have neglected to have their debentures stamped and new coupons attached thereto. Debenture holders who have either refused to assent or who have not been located and have not signified their assent or disapproval to the said Plan of Readjustment, own Debentures in the face amount of $174,500.

On October 1, 1932, the Corporation was unable to pay the Landlord the sinking fund rental of $150,000 then due, but was not entitled to an extension of the time of payment thereof by reason of the fact that it had been unable to comply with the other requirements of the said lease.

The Corporation is in default to the Landlord, for payments which have become due up to November 1, 1933, as follows:

Building Rental: Twenty-three months from December 1, 1931, up to and including November 1, 1933, at the rate of $12,950 per month, being 7% interest upon the balance unpaid upon the advance of $3,000,000, to wit—$2,220,000, or the sum of	$297,850.00
Ground Rent: Monthly ground rent from December 1, 1931, to November 1, 1933, at the monthly rental of $23,333.33 per month, twenty-three months	536,666.67
31 Steam and Electricity	22,985.22
Real Estate Taxes	$305,500.44
(On November 30, 1933, the further sum of $107,539.94 was payable on account of taxes, which the Corporation was unable to pay in full and the Landlord will probably be required to pay the same. The Landlord is entitled, under the terms of the lease, to interest upon the payments so made for the account of the Corporation.)	
Interest on Deferred Payments	42,497.07
Total due to the Landlord, as aforesaid	$1,205,449.40

In addition to the above indebtedness, the sum of $150,000.00 of sinking fund rental which became due on October 1, 1931, was deferred under the Plan of Readjustment above referred to. There is at present due and unpaid, sinking fund rental to the amount of $150,000.00 due October 1, 1932, and of $150,000.00 due October 1, 1933. The payment of said sum of $300,000.00, in case the Plan provided for herein is consummated, is to be made on or prior to the expiration of the first term of the lease.

The Roosevelt throughout its first few years of operation showed a satisfactory return. The earnings, after payment of taxes and the amounts due Landlord, but before depreciation, available for interest and sinking fund on the debentures, for the years 1928–1930, were as follows:

	Earnings
1928	$837,525.00
1929	978,161.00
1930	512,563.00

32 The Hotel has shown a deficit, after accruals for taxes, interest charges, and amounts due Landlord, but before depreciation, for the years 1931 and 1932 and the first ten months of 1933, as follows:

	Deficit
1931	$560,481.11
1932	993,568.92
1933 (Ten Months)	906,928.09

This drastic change in earning power seems to have resulted, not only from the depression, but from the large increase in hotel facilities in New York City.

These figures show conclusively that the Corporation cannot continue to function without a drastic reorganization. The Landlord for the past six months, by reason of the increasingly large sums due it, has been threatening to enforce its rights and take over the property, which action would exclude and make worthless the Debentures, Preferred and Common stock of the Corporation.

The security holders of the Corporation must bear in mind that there is a default, in the payment of rentals and taxes, aggregating in all as of November 1, 1933, $1,205,449.40 and that in addition sinking fund rentals in the amount of $300,000 are due and unpaid, and that the interest of the Corporation in the Hotel is predicated entirely upon its rights under the lease which said defaults give the Landlord the right to terminate.

The furniture, furnishings, and equipment of the Hotel belonging to the Corporation were pledged under the lease as security for the unpaid rent and the Landlord claims a lien thereon, which lien is in excess of the value of the furniture, furnishings, and equipment.

Drastic economies have been put into effect in operation, and the cost of operation, in the opinion of all concerned, has been for
33 many months at a minimum consistent with the proper operation of the Hotel. The Landlord, however, is unwilling to

permit the Corporation to continue in the defaults unless its capital structure is revised in such a manner as to permit the Corporation to carry on as a going concern and to take advantage of any recovery in general conditions, and the plan hereinafter referred to has been prepared with a view to meeting the requirement for such revision. The Plan is the result of numerous conferences between the representatives of the Landlord, the Corporation, and the Holders of securities of the Corporation. The Reorganization Committee provided for therein has undertaken the duties imposed upon them by the plan and the agreement with the thought that the plan and agreement give to the security Holders the best protection attainable, consistent with fairness to all concerned. The Committee and the Management of the Corporation are of the opinion that if this plan or some similar plan is not consummated, the security Holders will lose their entire investment; whereas, if this plan or a similar plan is consummated, the security Holders participating therein will have a reasonable chance of realizing a fair return on the new money invested and will save some part of their original investment depending, of course, upon the extent of the recovery in general business conditions, and the ability of the management to cope with the competition incident to the increased hotel facilities referred to above.

The Corporation also owes something under $50,000 to general merchandise creditors, and by reason of the Plan, when the same has been carried into effect, will probably have some additional creditors of a general nature, so that it seems advisable in this Plan to arrange for general creditors claims of approximately $100,000, subject to the exact facts as they materialize in the course of the carrying out of the Plan.

4 PLAN

A new corporation shall presently be formed under the laws of the State of Delaware or New York, as shall be determined by the Reorganization Committee, with the following capitalization:

Ten Year Six Per Cent Debentures: Authorized issue $1,500,000; to be dated on or about February 1, 1934; to bear interest at the rate of 6% per annum, when earned, in any year, payable annually, but to the extent unpaid to accumulate; callable at any time in whole or in part, at face amount and accumulated interest, plus interest at a like rate for the calendar year of call to the date of redemption; the Indenture securing the same to provide that no dividends shall be paid until Debentures are fully retired, and, further, that in each fiscal year the Board of Directors shall set aside surplus earnings beyond proper reserves for operation of the hotel, to be used to retire debentures or for the purchase thereof in the open market if the same can be purchased for less than the call price; to be issued only in registered form, without coupons. The debentures are to be secured by a chattel mortgage upon the furniture, equipment, and furnishings subject to the rights of the Landlord therein.

Preferred Stock: Authorized issue 26,500 shares; each share to be of the par value of $100; to be entitled to receive, but only after the debentures shall be fully retired, and all rental arrearages shall be fully paid, non-cumulative dividends at the rate of 6% per annum, in any year, when earned; to have no voting rights except such as provided by law; to be preferred as to dividends to the extent aforesaid, over the Common stock, and on any distribution of capital, after the debentures shall be retired, to be entitled to receive $100 per share and dividends at the rate of 6% per annum in the year of retirement, if earned, before any payment upon the Common stock.

Common Stock: Authorized issue 45,000 shares; each share to be of the par value of $5.00, and to be subject to the rights of the debentures and the Preferred stock; to have the entire voting rights of the Corporation, except as otherwise provided by law.

(The said new corporation will be hereinafter referred to as the New Company.)

In due course the Reorganization Committee will offer to purchase all of the assets of the Corporation, under the terms and conditions of this Plan, free and clear from all liens other than the rights of the Landlord under the lease, predicated upon the Landlord making a new lease with the New Company upon the terms and conditions hereinafter described under the heading "New Lease," or consenting to the assignment of the present lease, with modification thereof so that the present lease will conform to the terms and conditions of the lease provided for under the heading "New Lease." The Reorganization Committee reserves the right to determine as to how and in what manner the assets of the Corporation shall be acquired free and clear from all liens except as aforesaid, for the benefit of the New Company, under the Plan.

NEW LEASE.

In case the Plan be consummated, on or prior to March 1, 1934 or on or prior to such later date as may be approved by the Landlord the Landlord will either enter into a new lease with the New Company or consent to a transfer of the old lease to the New Company and a modification of the old lease, so that the resultant leasehold possessed by the New Company shall be changed from the existing leasehold in the following particulars:

(A) The Landlord will agree not to declare a default thereunder for non-payment of rentals during the period of three years from the date of the new lease or modification of the existing lease, as the case may be, in case during said period of three years the net earnings (as the same shall be defined therein) of the leased property up to the amount of the rentals reserved in the lease shall be paid to the Landlord as received and in case the Lessee shall also, during said period of three years, pay all operating expenses, including payment to the Landlord of taxes and service charges as they accrue and otherwise comply with the provisions of the lease;

(B) The Landlord will agree not to declare a default thereunder for non-payment of rentals during an additional period of two years beyond the period mentioned in Paragraph (A), in case during said additional period of two years the net earnings (as the same shall be defined therein) of the leased property up to the amount of the rentals reserved in the lease shall be paid to the Landlord as received, and in case the Lessee shall also, during said additional period of two years, pay all operating expenses, including payment to the Landlord of taxes and service charges as they accrue, and in addition thereto shall pay at least one-half of the Ground Rental and Building Rental reserved in the lease and otherwise comply with the provisions of the lease;

37 (C) Subsequent to the five-year period referred to in Paragraphs (A) and (B) above, all rentals provided for in the existing lease shall again become payable in full and the difference between the amount of rentals received by the Landlord during the said period of five years and the full amount of rentals reserved in the lease during said period, with interest, shall be paid to the Landlord as additional rental on or before the expiration of the first term of the lease in annual payments of substantially equal amounts;

(D) The indebtedness of the Lessee to the Lessor in the amount of $300,000.00 growing out of the nonpayment of the sinking fund rentals under the lease due October 1, 1932, and October 1, 1933, shall be paid to the Landlord as an additional rental on or prior to the expiration of the first term of the lease by annual payments of substantially equal amounts.

(E) During the period of five years referred to in Paragraphs (A) and (B) above and during such further period as any of the arrearages in rentals shall be unpaid, the Hotel shall be operated by a manager satisfactory to the Landlord, and his compensation and that of his staff shall be satisfactory to the Landlord, and the management, accounts, and expenditures relating to the Hotel shall at all times be subject to the approval of the Landlord;

(F) In case of default on the part of the Lessee under the new or modified lease as herein provided for, the Lessee upon written request of the Landlord and upon sixty days' previous written notice, shall assign the leasehold and any subleases, to the Landlord or a nominee of the Landlord, unless during such period of sixty days, such default shall be cured.

(G) The Landlord shall have a chattel mortgage upon the furniture, furnishings, and equipment as security for the payment of any arrearages in rentals.

38 WHEN PLAN DECLARED OPERATIVE

The Plan shall be declared operative when the following conditions shall have occurred:

A—When the Landlord shall have approved the same in writing and shall have executed the new lease to the New Company, or the modification of the old lease under the terms of the Plan; and

B—When the assets of the Corporation, free and clear from all liens, other than the rights of the Landlord under the lease, shall be assigned to the New Company, through the Reorganization Committee, by order of the proper court or courts, so that the New Company may commence operations.

VOTING TRUST

All of the Common stock of the New Company to be presently issued; shall be deposited under a voting trust agreement, for ten years, prepared by the Reorganization Committee in form satisfactory to the Landlord, which voting trust agreement shall provide for five Voting Trustees any of whom may be Directors of the New Company, and all of whom shall be initially selected by the Reorganization Committee, subject to the approval of the Landlord. The Voting Trust Agreement shall provide the method of selecting successor Voting Trustees. The Voting Trust Agreement shall further provide that when the Debentures of the New Company shall be entirely retired, the number of the Voting Trustees shall be reduced from five to three.

TREATMENT OF GENERAL CREDITORS OF THE CORPORATION

Each general creditor of the Corporation (the right being
39 reserved to pay such accounts as must be paid to continue operations) shall receive, upon due approval of his account by the Reorganization Committee or by a court of competent jurisdiction, a Voting Trust Certificate for one share of Common stock of the New Company for each $400 of indebtedness. Script will be issued for voting trust certificates for fractional shares.

TREATMENT OF INDEBTEDNESS DUE THE LANDLORD

As of November 1, 1933, the Landlord has an accrued account for defaults in payment of rentals under the terms and conditions of the leasehold of $1,205,449.40 in addition to the arrearages of $300,000.00 of sinking fund rental. It is deemed probable that the Landlord will be required to pay taxes due upon November 30th, 1933, of $107,539.94. To the extent of such indebtedness so accrued, to wit—$1,205,449.40 (excluding sinking fund rentals), and to the extent that the Landlord may be required to make an additional advance for the payment of said taxes, and to the extent of any additional rental arrearages (other than sinking fund rentals), said new Debentures of the New Company, on the consummation of the Plan, will be issued to the Landlord in face amount equal to the amount of such indebtedness, in satisfaction of such indebtedness. Accordingly, upon consummation of the Plan, there will be outstanding in the hands of the Landlord said Debentures of a face amount in excess of $1,300,000.

CASH REQUIREMENTS OF THE PLAN

The Landlord has required, as a condition of its agreement to the Plan, that the expenses of the Plan be not a charge upon the current earnings of the hotel. The Reorganization Committee has agreed to serve without charge. Nevertheless, a substantial sum is necessary in connection with the Plan, to meet printing bills, fees
40 due the State of incorporation of the New Company, fees of the Depositary under the Plan, fees of the Trustee under the Debenture issue, printing new Debentures, and Preferred and Common stocks, issuance tax due to the Federal Government upon such Debentures and stocks, fees of Receivers and Counsel, and other incidental expenses, which it is estimated will not exceed the sum of $70,000. All funds received from the sale of securities of the New Company will be used to defray these and other expenses of the plan.

TREATMENT OF DEBENTURES

Holders of Debentures of the Corporation will be entitled to purchase, for cash, Debentures of the New Company at par and accrued interest at the ratio of $10 face value of Debentures of the New Company for each $1,000 face value of Debentures of the Corporation surrendered (and proportionately for Debentures of the Corporation for lesser amounts). Upon the purchase and payment at par and accrued interest for such Debentures of the New Company, and the surrender of each $1,000 Debenture of the Corporation, the holder will receive, with each $10 face value of new Debentures, 5 shares of the Preferred stock of the New Company and a Voting Trust Certificate for 5 shares of Common stock of the New Company. Debenture holders of the Corporation who do not purchase Debentures in the New Company, will be entitled to receive, without payment therefor, upon surrender of each $1,000 Debenture of the Corporation, a Voting Trust Certificate for 2½ shares of the Common stock of the New Company.

TREATMENT OF PREFERRED STOCK

Likewise, each holder of 10 shares of Preferred stock of the
41 Corporation (and proportionately for lesser or greater amounts), who shall purchase from the New Company $5.00, face amount, of said new Debentures, at par and accrued interest, shall be entitled to receive, upon surrender of each 10 shares of Preferred stock of the Corporation held by him, Voting Trust Certificates for 5 shares of Common stock of the New Company. In the event that the said Preferred stockholders does not purchase such Debentures of the New Company, he shall have no participation under the Plan therein.

RESULTANT CAPITALIZATION OF NEW COMPANY

Assuming all of the Debenture holders and all of the Preferred stockholders of the Corporation accept the plan and purchase Debentures of the New Company as aforesaid, the resultant situation of the New Company would be as follows:

Debentures in the hands of the Landlord	$1,205,449.40
(This is subject to be increased by such amount as the Landlord may be compelled to pay toward the $107,539.94 taxes due November 30th, 1933, and additional rental arrearages.)	
Debentures in the hands of the present Debenture holders of the Corporation	51,113.00
Debentures in the hands of the present Preferred stockholders of the Corporation	19,071.00
Preferred stock outstanding in the hands of Debenture holders	25,567½ shares.
Common stock, all under Voting Trust:	
Voting Trust Certificates for Common stock outstanding, owned by Debenture holders of Corporation	25,567½ shares.
Owned by Preferred stockholders of Corporation	19,071¾ shares.
Owned by general creditors	200 shares.

42. RESERVATION BY REORGANIZATION COMMITTEE AS TO RIGHT TO ISSUE UNSUBSCRIBED SECURITIES

To the extent that the holders of the Debentures and of the Preferred Stock of the Corporation shall fail to subscribe for and purchase the new Debentures of the New Company, the Reorganization Committee reserves the right to issue such unsubscribed Debentures, together with the shares of Preferred Stock of the New Company and the Voting Trust Certificates representing shares of Common Stock of the New Company, which said Debenture holders and Preferred Stockholders of the Corporation would have been entitled to receive under the Plan had they subscribed for and purchased said new Debentures, to any other person, firm, corporation, or party who will subscribe for and purchase said new Debentures at the face value thereof; the subscription and purchase of the new Debentures in such case shall be without the surrender of the proportionate amount of Debentures and/or Preferred Stock of the Corporation which would otherwise have been surrendered if the Debenture holders and/or Preferred Stockholders of the Corporation had exercised their rights to subscribe for the said new Debentures under the Plan.

All financial and other representations and statements in this Plan are those of New York United Hotels, Inc., and while believed by the Committee to be accurate, are not representations by said Committee.

Dated New York, December 13, 1933.

BURTON A. HOWE,
CHARLES DOHERTY,
JUNIUS R. JUDSON,
WILLIAM A. SMART,
Reorganization Committee.

43 *Exhibit C–2 to stipulation of facts*

SUPPLEMENTAL OFFER OF ROOSEVELT HOTEL, INC.

The New Company referred to in the Plan and Agreement of Reorganization of New York United Hotels, Inc., dated December 13, 1933.

Loucks & Cullen, Counselors at Law, Equitable Building, 120 Broadway, New York City, N. Y.

In the Court of Chancery of the State of Delaware in and for New Castle County

FREDERICK W. ROCKWELL, COMPLAINANT

against

NEW YORK UNITED HOTELS, INC., A CORPORATION ORGANIZED AND EXISTING UNDER THE LAWS OF THE STATE OF DELAWARE, RESPONDENT

44 United States District Court for the Southern District of New York

In Equity No. E 77–68

FREDERICK W. ROCKWELL, PLAINTIFF

against

NEW YORK UNITED HOTELS, INC., DEFENDANT

To the Honorable ALFRED C. COXE, United States District Judge:

Supplementing the Offer made to the Receivers in the above-entitled causes, dated February 28, 1934, submitted to you on that date, to purchase the assets of New York United Hotels, Inc., under the Plan of Reorganization dated December 13, 1933, Roosevelt Hotel, Inc., hereby modifies the Offer so made as follows:

1. The Purchaser agrees to pay the said sum of Twenty-five Thousand Dollars ($25,000) contained in the original Offer, in addition to granting the participations to Debenture holders and Preferred stockholders of New York United Hotels, Inc., as set forth in the Plan and Agreement of Reorganization, and to continue such offer until April 1, 1934, or such further time as the Hon. Alfred C. Coxe shall determine, with the following specific modifications:

A—The Purchaser eliminates from the assets to be acquired the cash in the hands of the Receivers as of the close of business on February 28, 1934, and all accounts receivable of the Receivership, upon the understanding that the operations of the Receivers commencing with the opening of business upon March 1, 1934, shall be for the account of the Purchaser.

45 B—In arriving at this modification, the Purchaser understands the following:

(1) That the furniture, furnishings, facilities, and outfittings are subject to a chattel mortgage to New York State Realty and Terminal Company, in the sum, as of December 15, 1933, of $1,647,537.38. That the same have been appraised at forced sale value not to exceed $215,000, and a going value of approximately $900,000.

(2) That the leasehold in its present condition has been appraised as of no value.

(3) That the Receivers will pay from the cash retained and not sold to the Purchaser, all of their bills and contracts incurred by them, together with such sum as the Court shall determine eventually to be the reasonable value of use and occupancy during the Receivership up to March 1, 1934, together with such fees, allowances and expenses as shall be determined to be properly chargeable against the Receivership.

C—In addition to the aforesaid cash of $25,000, so to be paid for said assets, with the exception aforesaid, the Purchaser further states that in no way predicated upon the said Plan, but solely by reason of the fact that as a new company it will be compelled to do business with the individuals, firms, and companies that have been supplying food, beverages, and merchandise to New York United Hotels, Inc., and in order to obtain the lowest prices for its business; after it commences business, the Purchaser has decided that if this offer is accepted and the Plan is eventually consummated, it will assume as a matter of business discretion the amount of indebtedness due by New York United Hotels, Inc., to merchandise creditors for supplies furnished in the operation of the Hotel Roosevelt, amounting to $49,867.55, and the Purchaser will agree to pay the same.

ROOSEVELT HOTEL, INC.,
By WM. DEWEY LOUCKS and
ALFRED W. GRAY.

46 I, William J. Cullen, duly elected Assistant Secretary of Roosevelt Hotel, Inc., Do Hereby Certify that the following is a true and correct copy of a resolution adopted at the first meeting of the Board of Directors of said Corporation, duly called and held on the 21st day of February 1934, at which a quorum was present and acting thereat:

"Resolved, that discretionary powers be given unto Alfred W. Gray and Wm. Dewey Loucks, two members of this Board and associate counsel in connection with the Company, upon appearing at the proceedings so to be held before Hon. Alfred C. Coxe, to make such modification of such bid as presented by this Corporation as in their judgment shall seem necessary in order to carry into effect the said Plan and Agreement of Reorganization of New York United Hotels, Inc., dated December 13, 1933, subject only that said bid must be within the limitations of the requirements of said Plan."

In Witness Whereof, I have hereunto set my hand and duly affixed the seal of said Corporation, this 28th day of February, A. D. 1934.

WILLIAM J. CULLEN,
Assistant Secretary.

47 *Exhibit C–3 to stipulation of facts*

United States District Court, Southern District of New York
In Equity No. 77–68. Order Confirming Sale

FREDERICK W. ROCKWELL, PLAINTIFF

against

NEW YORK UNITED HOTELS, INC., DEFENDANT

This matter having come on to be heard on the 28th day of February 1934, the return day of the Order to Show Cause entered herein on February 7th, 1934, and George deB. Greene, one of the Receivers and Ancillary Receivers having appeared herein; and Graham, McMahon, Buell & Knox (Edward Ward McMahon of counsel) having appeared herein for Hugh M. Morris and George deB. Greene, the Ancillary Receivers in this jurisdiction and the Receivers in the State of Delaware; and Loucks & Cullen (William Dewey Loucks and William J. Cullen of counsel) having appeared herein for Burton A. Howe, Charles Doherty, Junius R. Judson and William A. Smart, the Reorganization Committee of New York United Hotels, Inc., and also for Roosevelt Hotel, Inc., the new Company referred to in the Plan of Reorganization, dated December 13th, 1933, and the purchaser herein; and Baldwin, Hutchins & Todd (Hiram C. Todd of counsel) having appeared herein for Frederick W. Rockwell, the plaintiff; and Alfred W. Gray having appeared herein for New York United Hotels, Inc., the defendant; and Olcott, Paul & Havens having appeared herein for Vera C. Kinneon, a noteholder; and Daniel F. Cohalan (Samuel Hoffman and George J. Langley of counsel) having appeared herein for William M. Holden, Arthur E. Campbell and Horatio W. Scott, Trustees of the Depositors'
48 Trust Fund of the People's National Bank of Barre, Vermont, and others, debenture holders; and Louis H. Strouse (by Archibald Palmer, of counsel) having appeared herein for certain creditors, and due proof having been filed of mailing on February 16th, 1934 of copies of said Order to Show Cause, dated February 7th, 1934, and of the Notice of Sale to each creditor and stockholder of the said New York United Hotels, Inc., defendant herein, whose name appeared on the lists of creditors and stockholders filed in this cause by said Receivers, together with due proof of the publication in the New York Evening Post on February 17th, 1934, of said Notice of Sale and of a Notice of Hearing on the approval of the Plan pursuant to the said Order to Show Cause, dated February 7th, 1934; and the Court having taken testimony as to the value of the prop-

erty to be sold, having received in evidence a Certificate of the Depositary under the Plan as to the number of creditors favoring the Plan, having received in evidence a report of the Ancillary Receivers, containing a statement as to the situation when they took charge, an account of the results of the operations under the receivership and their recommendations as to the fairness of the Plan, and George deB. Greene, one of the Receivers and Ancillary Receivers having testified as to the Plan and his recommendations thereon; and the Court having received in evidence the affidavits of Lester J. Lyon, dated February 28th, 1934 and George J. Donahue, dated February 28th, 1934 in opposition to the Plan; and having heard Samuel Hoffman, Archibald Palmer and George J. Langley in opposition to the Plan; and all persons interested in this cause and in the receivership estate including the defendant above named having been given an opportunity to be heard as to

"why an Order should not be granted adjudging that the Plan attached to and forming a part of the petition of the Reorganization Committee of New York United Hotels, Inc., dated February 7th, 1934 is fair and equitable and of advantage to all parties in
49 interest," and the Court having determined that the said Plan of Reorganization of New York United Hotels, Inc., dated December 13th, 1933, a copy of which is annexed to the petition of said Reorganization Committee of said New York United Hotels, Inc., is just, fair and equitable; and the said Order to Show Cause dated February 7th, 1934 having further provided that, in the event that said Plan shall be approved by this Court,

"all stockholders and creditors of New York United Hotels, Inc., are further directed to show cause at the same time and place why all of the property and assets of the New York United Hotels, Inc., and all assets which the Receiver and Ancillary Receivers have acquired or shall acquire, as the said assets may exist at the time of their transfer, should not be sold forthwith at public auction to the highest bidder by the Court upon the 'Terms of Sale' hereinafter set forth."

and the Court being of the opinion that the said Plan should be approved, and the Court having called for bids and Roosevelt Hotel, Inc., the new Company referred to in the Plan and Agreement of Reorganization of the New York United Hotels, Inc., dated December 13th, 1933, having duly qualified to bid for said property and having submitted its bid in writing and no other bid having been submitted, and the Court, having adjourned the sale until March 1st, 1934, at the same time and place and the Court upon such adjourned day, having reconsidered the Plan and having again heard Samuel Hoffman and George J. Langley in opposition thereto, and remaining of the opinion, after further considering the Plan and the objections thereto, that the said Plan was fair and equitable and of advantage to all parties in interest, and it appearing to the satisfac-

tion of the Court that the interests of all creditors and stockholders and other persons interested in the receivership estates of New
50 York United Hotels, Inc., would best be subserved by a sale of all of the assets of said New York United Hotels, Inc., and of the receivership estates thereof, and the said Roosevelt Hotel, Inc., the new Company referred to in the Plan and Agreement of Reorganization, dated December 13th, 1933, upon such adjourned date having submitted a Supplemental Offer herein, dated February 28th, 1934, and no other bid or Offer being submitted, and it appearing to the satisfaction of the Court, after hearing all parties in interest, that the acceptance of the said Offer of Roosevelt Hotel, Inc., dated February 28th, 1934, as modified by the aforesaid Supplemental Offer, dated February 28th, 1934, is proper and advisable, it is

Ordered, Adjudged, and Decreed that the Plan of Reorganization of New York United Hotels, Inc. (The Roosevelt), dated December 13th, 1933, a copy of which is annexed to the petition, dated February 7th, 1934, heretofore filed in this cause by the Reorganization Committee named in said Plan, is just, fair, and equitable and is hereby approved; and it is further

Ordered, Adjudged, and Decreed that all creditors and stockholders of the defendant and all other persons are forever barred from hereafter making objection or complaint to the said Plan of Reorganization; and it is further

Ordered, Adjudged, and Decreed that Hugh M. Morris and George deB. Greene, Ancillary Receivers of the above-named defendant corporation appointed by this Court be and they hereby are authorized and directed to cooperate with said Reorganization Committee and with the Delaware Receivers in consummating the said Plan of Reorganization and in carrying said Plan into effect; and it is further

Ordered, Adjudged, and Decreed that the Offer of Roosevelt
51 Hotel, Inc., the new Company referred to in the Plan and Agreement of Reorganization of New York United Hotels, Inc., dated December 13th, 1933, as modified by the Supplemental Offer of Roosevelt Hotel, Inc., dated February 28th, 1934, for the purchase of all of the property and assets of New York United Hotels, Inc., and all assets which the Receivers and Ancillary Receivers have acquired or shall acquire, as said assets may exist at the time of their transfer, except cash in the hands of the Receivers as of the close of business on February 28th, 1934, and all accounts receivable of the Receivers which accrued prior to March 1st, 1934, as the same are more particularly set forth and described in the Order to Show Cause, dated February 7th, 1934, be and the same hereby is approved and accepted and that Hugh M. Morris and George deB. Greene, the Ancillary Receivers herein, be and they hereby are directed to sell, convey, transfer, and assign all of the property and assets, *as the same are set forth in the said order to show cause dated Feb. 7, 1934*, and all assets which the Receivers

and Ancillary Receivers have acquired or shall acquire, as such assets may exist at the time of their transfer, except cash in the hands of the Receivers as of the close of business on February 28th, 1934, and all accounts receivable of the Receivers which accrued prior to March 1, 1934, ~~including, but not limited to, the property and assets mentioned and described in the said Order to Show Cause, dated February 7th, 1934,~~ to the purchaser, Roosevelt Hotel, Inc., its successors or assigns, upon compliance by Roosevelt Hotel, Inc., its successors or assigns, with all of the terms and conditions of its Offer, dated February 28th, 1934, as modified by its Supplemental Offer, dated February 28th, 1934, and of the Order to Show Cause, dated February 7th, 1934, and the "Terms of Sale" therein contained and of this Order; and it is further

Ordered, Adjudged, and Decreed that the property and assets sold hereunder shall be sold subject to and without prejudice to the
52 rights of the New York State Realty and Terminal Company, the New York and Harlem Railroad Company, the New York Central Railroad Company, and the Guaranty Trust Company of New York, as Trustees, as refefred to in the description of the property to be sold, contained in the said Order to Show Cause, dated February 7th, 1934, and subject to all the debts, contracts, and obligations incurred by the Ancillary Receivers appointed by this Court and by the Receivers appointed by the Court of Chancery of the State of Delaware, existing and unpaid at the time of the transfer of title to the purchaser, including all obligations assumed by said Receivers under contracts made by them and not yet fully performed by them, and for the purpose of securing the payment and full performance of all such debts, contracts, and obligations so incurred by the Ancillary Receivers appointed by this Court, this Court reserves a paramount lien and charge upon the property and assets sold hereunder. Upon the payment and full performance of such debts, contracts, and obligations, said Ancillary Receivers appointed by this Court shall make a report thereof to this Court and shall make an appropriate application for an order discharging said paramount lien. This Court reserves a further paramount lien and charge upon the property so to be sold to said Roosevelt Hotel, Inc., for the purpose of securing the complete consummation and carrying into effect of said Plan of Reorganization, dated December 13th, 1933. Upon said Plan being completely consummated and carried into effect, said Reorganization Committee shall make a report thereof to this Court and shall make an appropriate application to this Court for an order discharging said further paramount lien; and it is further

Ordered, Adjudged, and Decreed that upon payment to the Ancillary Receivers of the sum of Twenty-five Thousand Dollars ($25,000.00) and the creation and issuance of the securities called for in the said Plan, and upon delivery to the Purchaser, its suc-
53 cessors or assigns, of appropriate deeds of conveyance, and such other assignments, bills of sale, instruments of transfer,

and other assurances as may be appropriate to transfer the property sold to the purchaser, its successors or assigns, such purchaser, its successors or assigns, upon the production and delivery of such conveyances, assignments, bills of sale, instruments, instruments of transfer, and/or other assurances, or upon the production and delivery of certified copies thereof, shall be given possession of the property so sold, and such purchaser, its successors or assigns, shall, after such delivery of possession, hold, possess, and enjoy the same and every part and parcel thereof, free from all liens, claims, rights, interest, or equity of redemption of, in and to the same by or of the defendant, New York United Hotels, Inc., its successors and assigns, and by or of the creditors and stockholders of the said defendant, New York United Hotels, Inc., and by or of all persons claiming by, under, or through the defendant, its creditors or its stockholders, or by or of the receivers, and of all persons claiming by, through, or under them, or any of them, subject only, however, to the terms and conditions of the Order to Show Cause, dated February 7th, 1934, and the terms and conditions of the said Offer and Supplemental Offer and subject to compliance by the purchaser, its successors or assigns, respectively, with all terms and conditions on such purchaser imposed, respectively, by this decree and by the decree of confirmation of the Court of Chancery of the State of Delaware; and it is further

Ordered, Adjudged, and Decreed that the defendant, New York United Hotels, Inc., by its proper officers at the time of the execution of any deed or deeds or other instruments of conveyance, or transfer and assignment by the Receivers appointed by this Court, and by the Receivers appointed by the Chancery Court for the State of Delaware in and for the County of New Castle, for the prop-
54 erty sold, and by way of further assurance, deliver a similar deed or deeds or other instruments of conveyance, assignment, and transfer to the grantee or grantees in such deed or instrument and transfer, or, if any such purchaser or assignee shall so request, the said defendant shall join with the Receivers appointed by this Court, and with the Receivers appointed by the Chancery Court for the State of Delaware in and for the County of New Castle, in the execution of such deed or deeds or instruments of conveyance, assignment, and transfer so to be made by the said Receivers; and it is further

Ordered, Adjudged, and Decreed that the sale, as herein provided, of the said assets of the said defendant in this jurisdiction is conditioned upon the approval of such sale by the Court of Chancery in the State of Delaware in and for New Castle County and on the second Wednesday following the date of this Order, a report of the highest bid at this sale is to be made by the Delaware Receivers to the Court of Chancery of the State of Delaware, in and for the County of New Castle, at the County Courthouse at 11th and King Streets, Wilmington, Delaware, at 11 A. M., at which time and place,

said Court of Chancery of the State of Delaware will accept or reject said bid or make such decrees or orders as to it may seem just and proper and the purchaser shall not be deemed to have acquired any interest in the property sold hereunder until said purchaser's bid has been accepted by the Court of Chancery of the State of Delaware, in and for New Castle County; and it is further

Ordered, Adjudged, and Decreed that Roosevelt Hotel, Inc., the purchaser, be and it hereby is made a party to this proceeding and subjected to the jurisdiction of this Court and such jurisdiction is hereby retained over all parties in connection with the said offer of Roosevelt Hotel, Inc., and Supplemental Offer until such sale shall have been consummated and completed and all of the terms
55 and conditions of the Offer and Supplemental Offer for the purchase of the said assets have been fully and completely performed and the full consideration agreed to be paid and given in said Offer and Supplemental Offer shall have been fully paid and the terms and conditions of said Offer and Supplemental Offer and all obligations therein undertaken by Roosevelt Hotel, Inc., shall have been in all respects fully and completely performed; all such obligations shall survive the delivery of any and all instruments, transferring title either to the Roosevelt Hotel, Inc., its successors or assigns; and it is further

Ordered, Adjudged, and Decreed that the Ancillary Receivers, the Receivers, Reorganization Committee for New York United Hotels, Inc., and the Roosevelt Hotel, Inc., the Purchaser herein, may on not less than one day's notice apply to this Court at any time prior to the consummation of said sale and the carrying out of all of the obligations of said Offer and Supplemental Offer for such other relief at the foot of this decree as may be necessary or proper to conclude the purposes thereof.

Dated, New York, New York, March 8, 1934.

ALFRED C. COXE.

56 [Cover.] County Clerk's File No. E77-68. Year 193—. United States District Court, Southern District of New York. Frederick W. Rockwell, Plaintiff against New York United Hotels, Inc., Defendant. Order Confirming Sale. Loucks & Cullen, Attorneys for Reorganization Committee, Office and Post Office Address, Equitable Building, 120 Broadway, Borough of Manhattan, New York City. Stamped: (Filed Mar. 9, 1934. U. S. District Court, S. D. of N. Y.)

57 CERTIFICATES ATTACHED TO EXHIBITS C-1, C-2, C-3

UNITED STATES OF AMERICA,
Southern District of New York, ss:

I, Charles Weiser, Clerk of the District Court of the United States for the Southern District of New York, do hereby certify that the writings annexed to this Certificate have been compared with their

originals on file and remaining on record in this office; that they are correct transcripts therefrom and of the whole of said originals.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said court at the City of New York in the Southern District of New York, this 19th day of September, in the year of our Lord one thousand nine hundred and thirty-eight and of the Independence of the United States the one hundred and sixty-third.

[SEAL] CHARLES WEISER, *Clerk.*

58 *Exhibit D to stipulation of facts*

United States District Court, Southern District of New York

In Equity 77–68

FREDERICK W. ROCKWELL, PLAINTIFF

against

NEW YORK UNITED HOTELS, INC., DEFENDANT

The Ancillary Receivers herein having filed their final accounts in the office of the Clerk of this Court on the 1st day of May 1934, and Graham, McMahon, Buell & Knox, solicitors for said Ancillary Receivers, having filed in the office of the Clerk of this Court on the same date their petition for an allowance for service as such solicitors for the Ancillary Receivers in the amount of $10,000.00, and Baldwin, Hutchins & Todd, solicitors for the Complainant, having filed their petition for an allowance as such solicitors in the office of the Clerk of this Court on the same date in the amount of $5,000.00, and Edwin D. Steele, solicitor for the Receivers, appointed by the Court of Chancery in the State of Delaware, in and for New Castle County, having filed his petition in the office of the Clerk of this Court on the same date, for an allowance as such solicitor for the Receivers in the amount of $5,000.00 and consented that this Court fix the amount thereof, and Hugh M. Morris and George deB. Greene, Receivers in the State of Delaware, in and for the County of New Castle, having filed their applications asking that their compensation as such Receivers be fixed by this Court and due notice that the said applications would be brought before this Court on the 8th day of May 1934 at 4:30 o'clock in the afternoon, having been served upon each creditor and stockholder of the said New York United Hotels,
59 Inc., and upon all the parties who have appeared in this proceeding, and the said matters having come on to be heard on the 8th day of May 1934, the return day of said notice, at the time and place therein stated, and George deB. Greene, one of the Receivers and Ancillary Receiver having appeared herein; and Graham, McMahon, Buell & Knox (Edward Ward McMahon of Counsel)

having appeared herein for Hugh M. Morris and George deB. Greene, the Ancillary Receivers in this jurisdiction and the Receivers in the State of Delaware; and Loucks & Cullen (William Dewey Loucks and William J. Cullen of Counsel) having appeared herein for Burton A. Howe, Charles Doherty, Junius R. Judson, and William A. Smart, the Reorganization Committee of New York United Hotels, Inc., and also for Roosevelt Hotel, Inc., the purchaser herein; and Baldwin, Hutchins & Todd (Hiram C. Todd of Counsel) having appeared herein for Frederick W. Rockwell, the plaintiff; and Alfred W. Gray having appeared herein for New York United Hotels, Inc., the defendant; and Daniel F. Cohalan (Samuel Hoffman of Counsel) having appeared herein for George Donahue and other creditors; and Edwin D. Steele having appeared herein for George deB. Greene and Hugh M. Morris as solicitor for the Receivers, appointed by the Court of Chancery in the State of Delaware, in and for New Castle County, and due proof having been filed of mailing on May 1st, 1934, of copies of the Notice of Motion herein, dated May 1st, 1934, to each creditor and stockholder of the said New York United Hotels, Inc., defendant herein, whose name appeared on the lists of creditors and stockholders filed in this Court by said Receivers, together with proof of service of said Notice of Motion on all counsel who have appeared in the proceeding; and the Court having taken proof as to the Receivers' accounts and having received in evidence a general release from the purchaser, Roosevelt Hotel, Inc., to the Receivers, covering the operation of said hotel for the account of the purchaser
60 after March 1st, 1934, and the Court having received the affidavit of George J. Donahue, verified the 3rd day of May 1934, and the Receivers' final accounts having been filed in Court, and all persons interested in this cause and in the receivership, including the defendant above named, having been given an opportunity to be heard, and after having examined the accounts as filed as to any objections thereto, and there being no objection to the accounts or any statement appearing therein, and the Court having considered the application of Graham, McMahon, Buell & Knox as solicitors for the Receivers herein, for an allowance for their services, and having before it the application of Baldwin, Hutchins & Todd, solicitors for the Complainant, and their application for allowance for their services, and Edwin D. Steele as attorney for the Receivers in Delaware, having consented that this Court fix his allowance for services rendered in that proceeding, and the Court having the application of said Edwin D. Steele before it for consideration, and all parties having an opportunity to be heard thereon, and the Court having before it an application of the Receivers to fix the amount of the value of the use and occupation of the premises of the Roosevelt Hotel during the term of the receivership from December 15, 1933, to March 1, 1934, and the Court having before it for consideration the determination of a disposition of the balance in the hands of the Receivers, as shown by the Receivers' accounts amounting to $89,-

278.61 in cash, and accounts receivable in the amount of $8,352.00, having an estimated present value of $4,190.67; and the Court, after hearing all parties in interest, having filed its Memorandum of Opinion dated May 11, 1934, it is

Ordered, Adjudged, and Decreed, that the final accounts of Hugh M. Morris and George deB. Greene, Ancillary Receivers of New York United Hotels, Inc., appointed by this Court, which said accounts are on file in the office of the Clerk of this Court, be and the same hereby are approved; and it is further

61 Ordered, Adjudged, and Decreed that the following allowances are made to the Receivers and Counsel in this proceeding, to be paid by the Receivers out of the funds in their hands, in full for services rendered in this proceeding:

To George deB. Greene: for services as Receiver in Delaware	$500.00
For services as Ancillary Receiver in New York	4,500.00
To Hugh M. Morris: for services as Receiver in Delaware	500.00
For service as Ancillary Receiver in New York	3,000.00

To Messrs. Graham, McMahon, Buell & Knox:

In full for services and disbursements as solicitors and counsel for the Ancillary Receivers herein	10,000.00

To Messrs. Baldwin, Hutchins & Todd:

In full for services and disbursements a solicitors for the plaintiff herein	5,000.00
To Edwin D. Steele: in full for services as solicitor and counsel for the Receivers in Delaware	3,500.00

and it is further

Ordered, Adjudged, and Decreed, that the Ancillary Receivers herein pay over the remaining balance in their hands (after the payment of the foregoing allowances) amounting to $62,278.61 to the New York State Realty & Terminal Company, Landlord of the premises known as the Roosevelt Hotel, and that the said Ancillary Receivers assign, transfer, and set over the accounts receivable of said Receivers amounting to $8,352.00 to the said New York

62 State Realty & Terminal Company, the landlord of the premises herein, in full payment and satisfaction for use and occupation of the premises known as the Roosevelt Hotel, for the period of the receivership from December 15, 1933, to March 1, 1934, on condition that the said New York State Realty & Terminal Company within five days after the date of this order, file in the office of the Clerk of this Court, its written consent to pay out of said funds to the Roosevelt Hotel, Inc., to be disbursed by said Company, as hereinafter provided, such amount as will be sufficient to pay to the State of New York the sum of $534.61 in full for franchise taxes of New York United Hotels, Inc., for the year commencing November 1st, 1933, and to pay to the State of Delaware the sum of $150.00 in full for franchise taxes of New York United Hotels, Inc., and further, to pay to each Debenture holder and creditor of New York United Hotels, Inc. (other than merchandise creditors whose claims have already been assumed by the purchaser of the property

herein), a sum equal to $5.00 on each $1,000 Debenture and at the same rate on all Debentures of a lesser amount, and at the same rate on all allowed claims of other creditors of New York United Hotels, Inc., excepting merchandise creditors whose claims have already been assumed by the purchaser; such payments to be made provided within ninety days from the date of this order such payments shall be accepted in full satisfaction of such Debentures and/or claims, and upon surrender of said Debentures, with all unpaid coupons attached, and transfer of said claims, respectively, at the office of Roosevelt Hotel, Inc., Madison Avenue and 45th Street, in the City of New York, N. Y., against payment as hereinbefore directed; and it is further

Ordered, Adjudged, and Decreed that upon the payment by the said Receivers of the sums herein directed, and in the manner provided herein, that the said Receivers be and they hereby are discharged as Ancillary Receivers herein, and their bond given herein as such Ancillary Receivers cancelled.

Dated New York, N. Y., May 22, 1934.

ALFRED C. COXE.

63 "EXHIBIT D" COVER

In Equity 77-68. United States District Court, Southern District of New York. Frederick W. Rockwell, Plaintiff, vs. New York United Hotels, Inc., Defendant. Order with Notice of Settlement. Copy Received this 18th Day of May 1934. Baldwin, Hutchins & Todd (Baldwin, H. & T.) Solicitors for Plaintiff. Loucks & Cullen (Loucks & C.) Solicitors for Reorganization Committee. Olcott, Paul & Havens (Olcott P. & H.) Solicitors for Vira C. Kineoh. Daniel F. Cohalan (D. F. Cohalan) Solicitor for Trustee for Bondholders. L. H. Strouse (L. Strouse) Attorney for Petitioning creditors. Harry Sammet (H. Sammet) Attorney for Lester Lyons. Archibald Palmer (A. Palmer) of counsel to Intervening Creditor.
64 George Pheil (G. Pheil) Attorney for Frank Wahlberg, Intervening Creditor. Alan Emil (A. D. Emil) Attorney for Petitioning Creditors. Larkin, Rathbone & Perry (Larkin R. & P.), Solicitors for Central Union Trust Company, Trustees. Clive L. Handy (C. L. Handy) Attorney for New York State Realty & Terminal Company. Alfred W. Gray (A. W. Gray) Attorney for Defendant, New York United Hotels, Inc. John J. Bennett, Jr. (J. J. Bennett), Attorney General for the State of New York. AWJ. Graham, McMahon, Buell & Knox, One Cedar Street, New York.

65 CERTIFICATE ATTACHED TO EXHIBIT D

UNITED STATES OF AMERICA,
Southern District of New York, ss:

I, Charles Weiser, Clerk of the District Court of the United States for the Southern District of New York, do hereby certify that the writings annexed to this Certificate have been compared with their

originals on file and remaining on record in this office; that they are correct transcriptions therefrom and of the whole of said originals.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said court at the City of New York in the Southern District of New York, this 23rd day of September in the year of our Lord one thousand nine hundred and thirty-eight and of the Independence of the United States the one hundred and sixty-third.

[SEAL] CHARLES WEISER, *Clerk.*

66 *Exhibit E to stipulation of facts*

ROOSEVELT HOTEL INC.

THE ROOSEVELT

MADISON AVENUE AT 45TH STREET

NEW YORK, N. Y.

To the Holders of Twenty-Year Six Per Cent Sinking Fund Gold Debentures of New York United Hotels, Inc.; Due February 1, 1947:

The Receivers of New York United Hotels, Inc., have been discharged, and the assets of New York United Hotels, Inc., have been sold. Under the final order of the United States District Court for the Southern District of New York, the balance of the cash in the hands of the Receivers, amounting to the sum of $62,278.61, together with Accounts Receivable, good and bad, of the face amount of $8,352 was awarded to the Landlord for use and occupancy during the Receivership, and as part of the Receivership expenses, conditioned upon the Landlord making available therefrom a payment of $5.00 per $1,000 face amount of Debentures unto the holders of Debenture, and further provided said Debentures were surrendered with all unpaid coupons attached, on or before August 20th, 1934, in exchange for such cash.

You are therefore advised that the Landlord has made available the necessary amount of cash to Roosevelt Hotel, Inc., for such Debenture holders as care to take advantage of this provision made by the court.

Debentures heretofore deposited under the Plan and Agree-
67 ment of Reorganization of New York United Hotels, Inc., are not available to the original holder thereof for this purpose. Other Debenture holders are therefore invited to forward their Debentures, with all unpaid coupons attached, on or before August 20th, 1934, to Roosevelt Hotel, Inc., Madison Avenue and 45th Street, Borough of Manhattan, New York City, N. Y., and forthwith upon receipt thereof, with the enclosed letter of transmittal, duly executed, New York funds will be sent to such holders, at the rate of $5.00

per $1,000 face value of such Debentures, and proportionately for lesser amounts.

The time having been fixed by the Court will not be extended. The payment so made will be in full payment and settlement for said Debentures.

ROOSEVELT HOTEL, INC.,
By LOUIS A. BRUTY, *Treasurer.*

Dated New York, N. Y., May 26th, 1934.

68 *Exhibit F to stipulation of facts*

To ROOSEVELT HOTEL, INC.;
Madison Avenue at 45th Street, New York City, N. Y.

Enclosed herewith find $25,000.00 face amount of the Twenty-Year Six Per Cent Sinking Fund Gold Debentures, due February 1, 1947, of New York United Hotels, Inc., with all unpaid coupons attached, numbered M-4003/27, which are hereby surrendered by the undersigned, the owner thereof, under the terms of the order of the United States District Court for the Southern District of New York, to enable the undersigned to receive from the funds made available under such order, in full settlement of said Debentures, the ownership of which is hereby surrendered, $5.00 per $1,000 face amount of said Debentures, and proportionately for less than $1,000 thereof. The said sum of money representing the settlement for said Debentures is to be sent to me at the address below my name.

SAMUEL C. THOMSON,
(Signed) Samuel C. Thomson,
Owner and holder of the foregoing Debentures.

(Print address) Address % Customers Securities Dept., The New York Trust Co., 100 Broadway, New York.
Dated June 22, 1934.

69 Before United States Board of Tax Appeals

[Title omitted.]

Praecipe for transcript of record

Filed ug. 12, 1939

To the CLERK OF THE UNITED STATES BOARD OF TAX APPEALS:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Second Circuit copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Second Circuit heretofore filed by the above-named petitioners:

1. Docket entries of the proceedings before the Board.

2. Petition filed on November 13, 1937.
3. Answer filed on December 14, 1937.
4. Findings of fact and opinion of the Board promulgated on June 7, 1939.
5. Order entered on June 14, 1939.
6. Petition for review filed on August 9, 1939.
7. Notice of filing petition for review filed on August 9, 1939.

70 8. Stipulation of facts filed at hearing on November 28, 1938, including the following exhibits: Exhibit C1, C2, C3, D, E and F; and omitting Exhibits A, A1 and B.

9. This Praecipe for Record with admission of service thereof.

Said transcript to be prepared as required by law and the Rules of the United States Circuit Court of Appeals for the Second Circuit.

(Signed) T. F. DAVIES HAINES,
Attorney for Petitioner,
T. F. Davies Haines,
63 Wall Street, New York City.

Service of a copy of this Praecipe is hereby admitted this 12th day of August 1939.

(Signed) J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Internal Revenue Building, Washington, D. C.

71 [Clerk's certificate to foregoing transcript omitted in printing.]

72 In United States Circuit Court of Appeals for the Second Circuit

No 131—October Term, 1939

(Argued November 22, 1939. Decided January 8, 1940)

S. C. THOMSON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the Board of Tax Appeals

Petition by S. C. Thomson to review a decision of the Board of Tax Appeals, redetermining a deficiency in income tax for 1934.

Reversed.

Before L. HAND, CHASE, and PATTERSON, Circuit Judges.

Appleton, Rice & Perrin (Lee J. Perrin, Clifton S. Thomson, and T. F. Davis Haines, of counsel), for petitioner. Samuel O. Clark, Sewall Key, and Helen R. Carloss, for respondent.

73 *Opinion*

PATTERSON, Circuit Judge:

In his income-tax return for 1934 the petitioner claimed a deduction of $24,625 for a bad debt. The commissioner disallowed the deduction and determined a deficiency in tax. The Board of Tax Appeals sustained the commissioner.

The petitioner in 1927 purchased $25,000 face amount of debentures of New York United Hotels, Inc., paying $24,750 for them. The debentures were part of an issue of $5,300,000. The issuing company in 1931 ran into difficulties and obtained concessions from debenture holders in postponement of interest payments and waiver of sinking fund requirements. The situation became much worse later, and in December 1933 receivers were appointed by the district court on creditor's bill. In the plan of reorganization approved by the district court in March 1934, no provision was made for debenture holders who declined to put in new money. In the final decree of May 22, 1934, however, the receivers were directed to pay $5 in full settlement for each $1,000 debenture surrendered by debenture holders for cancellation. The petitioner in June 1934 took advantage of this provision and surrendered his $25,000 debentures, receiving $125 in cash. This was a loss of $24,625, and the petitioner claimed in his 1934 return a deduction of this amount as a bad debt.

The case then is one where the debentures proved on insolvency of the debtor company to be almost completely worthless. The petitioner, who had paid $24,750 for them, realized $125 on them when he turned them in to the receivers for cancellation. The Revenue Act of 1934, by express provision in section 23 (k), permitted the deduction of the unrecoverable part of debts partially worthless. The applicable regulations, Regulation 86, article 23 (k), mentioned

74 as examples of bad debts the difference between the amount received on distribution of the assets of a bankrupt debtor and the amount of the claim, and the difference between the amount received by a creditor of a decedent on distribution of the estate and the amount of the claim. The example of a debt rendered partially worthless by bankruptcy of the debtor virtually covers the present case. But the Board took the view that the case was one of "retirement" of the debentures within section 117 (f) of the 1934 Act and so was an instance of a capital loss rather than of a bad debt. If the transaction was a capital loss, the petitioner, for reasons that require no discussion, was not entitled to deduct the loss from income.

Section 117 dealt with capital gains and losses. It provided that percentages of the gain or loss on sale or exchange of a capital asset should be taken into account in computing net income, and it imposed limitations on the allowance of losses from sales or exchanges. Subsection (f), a new provision in income tax acts, read:

"For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes or certificates or other

evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

We are of opinion that what happened here may not fairly be taken as a "retirement" of the petitioner's debentures. Dictionary definitions of "retire" are "to pay up and withdraw from circulation," "to withdraw from circulation or from the market," "to take up or pay." The word signifies some voluntary action on the debtor's part in fulfillment of his promise to pay. A man as sanguine as Micawber might describe his bankruptcy as a "retirement" of his obligations, but a merchant seeking credit who spoke in such euphemisms might find himself in trouble later. Where creditors receive a petty dividend (one-half of one percent in this case) on the collapse of their debtor, their claims may be extinguished but are hardly "retired." The Board was in error in treating the case as one of "retirement" of the petitioner's debentures.

The case was one of bad debt. To support a deduction for bad debt in a particular year, however, the taxpayer must show that the debt was ascertained to be worthless in that year and that he charged it off in that year. Spring City Co. v. Commissioner, 292 U. S. 182. While the facts here would support findings that the petitioner ascertained the debt to be worthless in 1934 and that he charged it off in that year, the Board made no findings on these issues. We have no power to supply findings. Helvering v. Rankin, 295 U. S. 123. Under such circumstances the case will be remanded to the Board for further findings.

Reversed.

In United States Circuit Court of Appeals, Second Circuit.

S. C. THOMSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal From the United States Board of Tax Appeals

Judgment

Filed Jan. 25, 1940

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is reversed, and cause remanded.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

D. E. ROBERTS, *Clerk.*

77 [File endorsement omitted.]

78 [Clerk's certificate to foregoing transcript omitted in printing.]

79 Supreme Court of the United States

Order allowing certiorari

Filed May 20, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is assigned for argument immediately following No. 914.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 44353. U. S. Circuit Court of Appeals, Second Circuit. Term No. 58. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. S. C. Thomson. Petition for a writ of certiorari and exhibit thereto. Filed April 25, 1940. Term No. 58 O. T. 1940.

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FILE COPY

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APR 15 1940
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. [redacted] 55

DONALD S. McCLAIN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

M. E. KILPATRICK,
E. D. SMITH, JR.,
Counsel for Petitioner.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1939

DONALD S. McCLAIN, PETITIONER

vs.

THE COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

No.....

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner respectfully petitions for a writ of certiorari to review a judgment of the Circuit Court of Appeals for the Fifth Circuit, and for reason therefor respectfully shows the following:

JUDGMENT AND OPINION BELOW

The judgment sought to be reviewed was entered on March 23, 1940, by the Circuit Court of Appeals for the Fifth Circuit in the case of "Donald S. McClain, Appellant, v. Commissioner of Internal Revenue, Appellee" (R. p. 30).

The judgment of the Circuit Court of Appeals aforesaid affirmed the decision of the Board of Tax Appeals. The memorandum opinion of the Board of Tax

Appeals appears (R. p. 19). The decision of the Board of Tax Appeals appears (R. p. 21).

STATUTES INVOLVED

The *Revenue Act of* 1934 is involved in this controversy and this controversy turns upon the construction of *Section* 117 (*f*) thereof.

Revenue Act 1934, *Section* 117 (*f*)

> "Retirement of bonds, etc.—For the purposes of this title, amounts received by the holder upon the *retirement* of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

REASONS FOR GRANTING WRIT

The revenue of the United States of America is involved in this controversy. A direct conflict exists between the Fifth Circuit Court of Appeals in this opinion, and the Second Circuit Court of Appeals in the case of *S. C. Thomson v. Commissioner of Internal Revenue*, 108 *Fed.* (2) 642 (January 8, 1940). Both of these cases deal with the meaning of the word "retirement" as used in *Section* 117 (*f*) of the *Revenue Act of* 1934, and the two courts come to exactly opposite conclusions as to the meaning of that word as there used.

QUESTION PRESENTED

The sole question here presented is whether bonds of a corporation or a political subdivision of a state

are "retired" within the meaning of *Section* 117 (*f*), *Revenue Act of* 1934, when the debtor becomes insolvent and unable to meet its obligations, and the creditor receives payment on the bonds at less than the face value thereof. If a "retirement" is thus effected, the loss is limited by the capital loss provisions of the Revenue Act; if a "retirement" is not thus effected, the loss suffered is as a bad debt and deductible in full by the creditor, taxpayer, under *Section* 23 (*k*) *of the Revenue Act of* 1934.

STATEMENT OF THE CASE

In 1918 Donald S. McClain received as a gift from his father bonds of the Cameron County Water District (Texas) of the face amount and of the value of $15,000. The Cameron County Water Improvement District was a political subdivision of the State of Texas. (R. p. 14)

In 1935 the said water district became financially embarrassed and was in default on both principal and interest on its outstanding bonds. (R. p. 16). After an unsuccessful attempt at bankruptcy, said attempt being unsuccessful because the Municipal Bankruptcy Act was declared unconstitutional, the water district applied to the Reconstruction Finance Corporation for a loan. In the year 1935 it was successful in securing a loan from that corporation to the extent of $264,500, this being sufficient to pay 49.9 per cent of its outstanding bonds. (R. p. 15). The Reconstruction Finance Corporation, prior to making this loan, had made a survey of the properties of the water district and general conditions and had determined that the loan made

was the maximum amount that the water district could stand, and at the same time, meet its current liabilities and charges. (R. p. 16)

After securing this loan from the Reconstruction Finance Corporation, the Cameron County Water District paid to Donald S. McClain the sum of $7,476.75, which amounted to 49.9 per cent of his bonds. (R. p. 17). In view of all of the circumstances bearing upon the financial responsibility of the water district and its inability to meet its obligations, Donald S. McClain accepted this payment and in turn determined the balance of these bonds to be uncollectible in year 1935, and in that year charged off on his books the sum of $7,523.25 as uncollectible, and in his income tax for that year claimed a deduction of that amount, pursuant to the provisions of *Section* 23 (*k*) of the *Revenue Act* of 1934. In other words, he treated the loss suffered by him as a loss upon a debt becoming partially worthless and uncollectible. In fact, the debt became uncollectible during 1935, except to the extent of 49.9 per cent on the dollar. (R. p. 18)

The understanding of Donald S. McClain in accepting the amount agreed on was that he would receive the payment thereon at the rate of 49.9 per cent and that such payment was to be the only amount he would receive. However, there was no writing to evidence this, nor in fact any agreement between the district and the bondholders to this effect. (R. p. 18)

The Commissioner in auditing the returns of Mr. McClain disallowed this deduction and assessed a deficiency. The disallowance of the Commissioner was

based upon his contenton that the bonds had been "retired" within the meaning of *Section* 117 (*f*) of the *Revenue Act of* 1934, and, consequently, the loss suffered was a capital loss limited to $2,000.

CERTIFICATION OF ERROR

The Circuit Court of Appeals erred:

1. In its ruling that the bonds in question were retired within the meaning of *Section* 117 (*f*) of the *Revenue Act of* 1934.

2. In its ruling that the bonds were retired and in ruling that petitioner was not entitled to deduct the loss suffered as for a bad debt.

3. In affirming the decision of the United States Board of Tax Appeals.

IMPORTANCE OF QUESTION

The question here involved is highly important in the administration of the Revenue laws of the United States, because it is a question which is constantly recurring. In every bankruptcy and in every compromise with creditors governed by the Revenue Acts of 1934 and through 1937, the question arises whether the obligations of the insolvent or financially embarrassed debtor are retired within the meaning of *Section* 117 (*f*) of the Revenue Act of 1934, or whether the loss suffered by the creditor is to be treated as a loss upon a debt becoming worthless and treated under *Section* 23 (*k*) of that revenue act. With the irreconcilable conflict existing between the Circuit Court of Appeals

of the Fifth Circuit and the Circuit Court of Appeals of the Second Circuit, endless litigation must necessarily result. It is, therefore, highly important that this court grant ceritorari and settle definitely and finally this question so that taxpayers and litigants may be able to determine their controversy without the necessity of prolonged and expensive litigation.

CONCLUSION

For the reasons stated, it is respectfully submitted that the writ of ceritorari be granted.

DONALD S. MCCLAIN

By M. E. KILPATRICK,
E. D. SMITH, JR.,
Attorneys for Petitioner.

1045 Hurt Building,
Atlanta, Georgia

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

The decision sought to be reviewed is at pages 30-34 of the record.

JURISDICTION

The jurisdiction of this honorable court is based upon *Section* 240 of the *Judicial Code* as amended by the Acts of February 13, 1925 (*Title* 28 *U.S.C.A. Section* 347).

QUESTION INVOLVED

The question involved in this petition for certiorari turns entirely upon the construction of the word "retirement" as used in *Section* 117 (*f*) of the *Revenue Act of* 1934. Reference must also be had to *Section* 23 (*k*) of the same revenue act in dealing with this situation.

CONFLICT BETWEEN CIRCUITS

S. C. Thomson v. the Commissioner of Internal Revenue, 108 *Fed.* (2*d*) 642 (*January* 8, 1940).

Mr. Thomson owned twenty-five thousand dollars ($25,000.00) of the debentures of New York Hotel, Inc. In 1935, after that company had secured an extension from its debenture holders and after receivers had been appointed in the United States District Court on a creditor's bill, Mr. Thomson received a final dividend on his bonds at the rate of five dollars ($5.00) per thousand, thus receiving in all, one hundred twenty-five dollars ($125.00). This payment was the only and final payment on said bonds. In his income tax return for 1935 he treated this loss as a bad debt loss under *Section* 23 (*k*) of the *Revenue Act of* 1934. The

Commissioner disallowed this deduction and treated the loss as having been suffered upon the retirement of the bonds and hence treated the loss as a capital loss under *Section* 117 (*f*) of that revenue act. The Board of Tax Appeals upheld the Commissioner. The Circuit Court of Appeals for the second circuit reversed the Board of Tax Appeals and held that bonds were not retired within the meaning of the Revenue Act when upon the collapse of the debtor they were paid off at less than face value.

From this statement of the Thomson case, it becomes apparent that this case is in irreconcilable conflict with the decision of the Circuit Court of Appeals of the Fifth Circuit in the case here presented by this petition.

INTENTION OF CONGRESS

1.

The prior law allowed a full deduction for loss suffered upon bonds becoming worthless or partially worthless.

Fairbanks v. the United States, 306 *U. S.* 436, 59 *Sup. Ct. Rep.* 607;

Henry R. Hunting v. the Commissioner, 32 *B.T.A.* 495 (*bonds partially worthless*);

John H. Watson v. the Commissioner, 27 *B.T.A.* 463 (*reversing Henry P. Werner*, 15 *B.T.A.* 482);

Paul and Merten, Law of Federal Income Taxation, par. 28.87.

2.

Section 117 (*f*) of the *Revenue Act of* 1934 was aimed at the situation created by the *John H. Watson* case (27 *B.T.A.* 463) which, for the first time, allowed a full deduction for the loss suffered by a bond holder when his bonds matured and were paid off in full. This case was decided December 29, 1932 after the enactment of the *Revenue Act of* 1932. Congress did not have an opportunity to correct this situation until the *Revenue Act of* 1934. The 1934 Act did not attempt to deal with the situation where bonds became worthless or partially worthless.

Revenue Act 1934, *Section* 23 (*k*),

Regulation 86, *Art.* 23 (*k*) 4.

3.

The intention of Congress in the *Revenue Act of* 1934 was made more clear by the *Revenue Act of* 1938, wherein *Section* 23 (*k*) was specifically amended to cover this very situation.

Revenue Act of 1938, *Section* 23 (*k*), 2;

House of Representatives Report No. 1860, *75th Congress, 3rd Session, appearing* 1939-1 *Cumulative Bulletin, page* 728 *at page* 740.

4.

Had Congress intended to cover this situation in 1934, it could easily have added *Section* 23 (*k*) in that year. Also, had Congress thought that the amendment in 1934 covered this situation, then the addition of

sub-Section 2 to Section 23 (k) in the *Revenue Act of* 1938 was a useless thing and without meaning. (The 1938 Act was enacted prior to the decision of the S. C. Thomson case, supra.)

Fairbanks v. the United States, 306 *U. S.* 436, 59 *Sup. Ct. Rep.* 607;

Stewart v. the United States, 106 *Fed.* (2d) 405, *Headnote* 8.

CONFUSION WITHIN FIFTH CIRCUIT COURT OF APPEALS

Confusion exists within the decisions of the Fifth Circuit Court of Appeals by virtue of the case of *W. A. Thomas, Collector v. Perkins*, 108 *Fed.* (2d) 87 (December 7, 1939) which is contrary to its decision in the present case.

BOARD OF TAX APPEALS

The Board of Tax Appeals in dealing with this exact question recognizes that in a proper case loss suffered on bonds becoming worthless, may be deducted in full under the *Revenue Act of* 1934. Such a proper case is here presented.

Austin Corbin, 2d, v. the Commissioner, 39 *B.T.A.* 1163, *at page* 1169.

Respectfully submitted,

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Supreme Court of the United States

OCTOBER TERM, 1940

DONALD S. McCLAIN, *Appellant*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Appellee*

NO. 55

CITATION OF CASE IN LOWER COURTS

Donald S. McClain vs. Commissioner of Internal Revenue, 110 Fed. (2) 878.

JURISDICTION

The jurisdiction of this honorable court is based upon Section 240 of the Judicial Code as amended by the Acts of February 13, 1925 (Title 28 U.S.C.A. Section 347), certiorari having been granted May 20, 1940.

QUESTION PRESENTED

The sole question here presented is whether bonds of a corporation or a political subdivision of a state are "retired" within the meaning of Section 117 (f), Revenue Act of 1934, when the debtor becomes insolvent and unable to meet its obligations, and the creditor receives a payment on the bonds less than the face value thereof. If a "retirement" is thus affected, the loss is limited by the capital loss provisions of

the Revenue Act; if a "retirement" is not thus effected, the loss suffered is as a bad debt and deductible in full by the creditor, taxpayer, under Section 23 (k) of the Revenue Act of 1934.

STATEMENT OF THE CASE

In 1918 Donald S. McCain received as a gift from his father bonds of the Cameron County Water District (Texas) of the face amount and of the value of $15,000. The Cameron County Water Improvement District was a political subdivision of the State of Texas. (R. pp. 14 and 15.)

In 1935 the said water district became financially embarrassed and was in default on both principal and interest on its outstanding bonds. (Tr. p. 15.) After an unsuccessful attempt at bankruptcy, said attempt being unsuccessful because the Municipal Bankruptcy Act was declared unconstitutional, the water district applied to the Reconstruction Finance Corporation for a loan. In the year 1935 it was successful in securing a loan from that corporation to the extent of $264,500, this being sufficient to pay 49.9 per cent of its outstanding bonds. (R. pp. 15 and 16.) The Reconstruction Finance Corporation, prior to making this loan, had made a survey of the properties of the water district and general conditions and had determined that the loan made was the maximum amount that the water district could stand, and at the same time, meet its current liabilities and charges. (R. p. 17.)

After securing this loan from the Reconstruction Finance Corporation, the Cameron County Water District paid to Donald S. McCain the sum of $7,476.75, which amounted to 49.9 per cent of his bonds. (R. p. 17.) In view of all of the circumstances bearing upon the financial responsibility of the water district and its inability to meet its obligations,

Donald S. McCain accepted this payment and in turn determined the balance of these bonds to be uncollectible in year 1935, and in that year charged off on his books the sum of $7,523.25 as uncollectible, and in his income tax for that year claimed a deduction of that amount, pursuant to the provisions of Section 23 (k) of the Revenue Act of 1934. In other words, he treated the loss suffered by him as a loss upon a debt becoming partially worthless and uncollectible. In fact, the debt became uncollectible during 1935, except to the extent of 49.9 per cent on the dollar. (R. p. 18.)

The understanding of Donald S. McClain in accepting the amount agreed on was that he would receive the payment thereon at the rate of 49.9 per cent and that such payment was to be the only amount he would receive. However, there was no writing to evidence this, nor in fact any agreement between the district and the bondholders to this effect. (R. p. 18.)

The Commissioner in auditing the returns of Mr. McClain disallowed this deduction and assessed a deficiency. The disallowance of the Commissioner was based upon his contention that the bonds had been "retired" within the meaning of Section 117 (f) of the Revenue Act of 1934, and, consequently, that the loss suffered was a capital loss limited to $2,000.

CERTIFICATION OF ERROR

The Circuit Court of Appeals erred:

1. In its ruling that the bonds in question were retired within the meaning of Section 117 (f) of the Revenue Act of 1934.

2. In its ruling that the bonds were retired and in ruling that petitioner was not entitled to deduct the loss suffered as for a bad debt.

3. In affirming the decision of the United States Board of Tax Appeals.

ARGUMENT

I. INTENTION OF CONGRESS

Did Congress intend the word "retirement," as used in Section 117 (f) to include the situation where an insolvent debtor pays a portion only of its obligations? To determine the intention of Congress, appellant feels it important to trace the history of this section from the Revenue Act of 1932 to date.

The Revenue Act of 1932 did not include Section 117 (f) and it was held under the provision of that Act that bonds becoming worthless could be charged off as a bad debt in the full amount.

Paul and Mertens Law of Income Taxation, par. 28.87.

> "Bonds Which Have Become Worthless. There has been conflict as to whether worthless bonds could be deducted under the bad debts provision of the statutes. The later decisions generally clarified the situation so that now a deduction for worthless bonds may, if all circumstances warrant it, be taken as a bad debt; the latest decisions are in accord with some earlier decisions which allowed the deduction as bad debts, and with the regulations providing:
>
> "'Where bonds purchased before March 1, 1913, depreciated in value between the date of purchase and that date, and were in a later year ascertained to be worthless and charged off, the owner is entitled to a deduction in that year equal to the cost of the bonds. Bonds purchased since February 28, 1913, when ascertained to be worthless, may be treated as bad debts to the amount

actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year. A deduction for a bad debt based upon the value of the debt on March 1, 1913, is allowable only when such value is established to the satisfaction of the Commissioner.'

"The general rules regarding the deduction of worthless bonds are not essentially different from those governing worthless debts generally. The taxpayer who seeks to deduct worthless bonds as bad debts must show that the debt was ascertained to be worthless and charged off. Indebtedness evidenced by bonds may be ascertained to be worthless before the maturity of the bonds. The fact that bonds have been sold at a nominal price does not preclude deductibility."

See also *Merrit J. Corbett v. Commissioner*, 15 B. T. A. 698.

It was also held that bonds which were determined to be partially uncollectible could be charged off as bad debts to the extent of their uncollectibility. *Huntting v. Commissioner*, 32 B. T. A. 495.

It was also held, generally, that amounts lost by the composition with an insolvent debtor could be charged off as a bad debt. *Pacific Novelty Co. v. Commissioner*, 5 B. T. A. 1017. See also *James Sweinhart*, 29 B. T. A. 1179.

It was generally held also that those transactions which amounted to a retirement, that is where bonds were called and paid at par, resulted in an ordinary loss. This was established by the decision of *John H. Watson v. Commissioner*,

27 B. T. A. 463, decided by the Board of Tax Appeals, on December 29, 1932. (The ruling in this case was specifically approved by this court in *Fairbanks v. U. S.*, 306 U. S. 436, 59 Sup. Ct. 607.) This reversed the case of *Henry P. Werner*, 15 B. T. A. 482, wherein it had been held that the retirement of bonds by the payment therefor at maturity resulted in the capital gain or loss as the case might be. The Watson case has been followed consistently by the Board since 1932. John H. Watson, supra, at page 465:

> "On further consideration we are of the opinion that the Board erred in its holding in Henry P. Werner, supra. It is elemental that where a statute is clear and unambiguous in its terms and provisions resort should not be had to legislative history to determine the limits of its compass. The statute in question is so simple in construction and so clear in meaning that it justifies no resort to the Congressional Committee's report as an aid in the interpretation thereof.
>
> "The words 'sale or exchange' are ordinary words of well established meaning. Taken in their context they are susceptible of no misconstruction. Payment of the amounts specified in the bonds, either at maturity or pursuant to an authorized call prior to maturity, is not a 'sale or exchange' of such bonds. It is merely the payment of an obligation according to its fixed terms. For these reasons we believe the decision in Henry P. Werner, supra, was erroneous and it is accordingly overruled.
>
> "In the instant case there was neither a 'sale' nor an 'exchange' of a capital asset when the Liberty bonds were paid at maturity. There was the satisfaction of an obligation of the United States by payment. Loss incurred or gain realized in such a transaction is not a capital loss or a capital gain under the definition found in the statute.

"Following the same thought further we are of the opinion that I. T. 1637 correctly interpreted Section 206 of the Revenue Act of 1921 and corresponding provisions of the later acts and that I. T. 2488, which went even further than the Werner case, is an erroneous interpretation."

Arthur E. Braun, Trustee, 29 B. T. A. 1161, at page 1177:

"Petitioner's contention on this point must be sustained. The Revenue Act of 1926 (Sec. 208(a)) defines 'capital gain' as meaning taxable gain from the sale or exchange of capital assets consummated after December 31, 1921. The bonds in question were capital assets, but they were not sold or exchanged. Payment of the amount specified in a bond, either at maturity or pursuant to an authorized call prior to maturity, is not a sale or exchange of such bond, and the gain derived from the transaction is taxable as ordinary income. John H. Watson, Jr., 27 B. T. A. 463. The deficiency for 1927 will be redetermined accordingly."

To the same effect see:

J. Garfield Buell v. Commissioner, 106 Fed. (2d) 398.
Fairbanks v. United States, 306 U. S. 436, 59 Sup. Ct. 607.

It is evident from the authorities set out above that had the transaction here involved taken place prior to the enactment of the Revenue Act of 1934 that the loss suffered would have been properly treated as a bad debt loss, and so treated by the Commissioner of Internal Revenue.

The question remains to be determined whether the Revenue Act of 1934 altered the situation with regard to the partial payment of the principal of bonds by an insolvent debtor.

If this charge in the prior law was affected by the Revenue Act of 1934, it must have been affected by Section 117. (f) which provides "Amounts received by the holder upon the retirement of bonds, debentures, notes, certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof) with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

It would appear that Section 117 (f) was aimed directly at the situation presented by the *John F. Watson* case. It must be borne in mind that the Watson case was decided on December 29, 1932, after the enactment of the Revenue Act of 1932, which was enacted on June 6, 1932. Congress did not have an opportunity to alter the law with regard to the *John F. Watson* case until the enactment of the Revenue Act of 1934. It has been decided too many times to warrant citations of cases that words in the Revenue Act are taken in their usual sense. Hence the word "retirement" must be used in its ordinary sense. The word "retirement" as used in connection with corporate financing means the *payment* of any corporate obligation in full at maturity. It does not have reference to the compromising of corporate obligations or an incomplete or partial payment thereof.

Indeed, had Congress intended to direct the Revenue Act of 1934 to the situation presented by this appeal, it could have easily done so by amending Section 23 (k). The intention not to alter the situation presented by the compromise of a debt by an insolvent debtor is quite apparent from the fact that Section 23 (k) was not amended. It is submitted that the amendment to Section 117, as above set out, was adopted purely and simply to cure the situation which had arisen from the *John F. Watson* case. The Commissioner's regulations

with regard to bad debts remained unchanged after Section 117 (f) was enacted.

REGULATION 86

"Art. 23 (k)-4. Worthless bonds and similar obligations.—Bonds, if ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for subsequent year."

The fact that the intention of Congress was directed purely and simply to the retiring of bonds at the face amount upon maturity is further demonstrated by the amendments to the law in the Revenue Act of 1938. In this Revenue Act, Section 23 (k) was amended to take care of situations similar to those presented here. There was added to Section 23 (k), sub-section 2, which reads as follows:

"SECURITIES BECOMING WORTHLESS.—If any securities (as defined in paragraph (3) of this sub-section) are ascertained to be worthless and charged off within the taxable year and are capital assets, the loss resulting therefrom shall, in the case of a taxpayer other than a bank, as defined in Section 104, for the purposes of this title, be considered *as a loss from the sale or exchange*, on the last day of such taxable year, of capital assets." (Italics ours.)

As further showing the intent of Congress on this same point, reference is made to the House Committee on Ways and Means Report in regard to the Revenue Act of 1938, at page 18:

"Under Section 23 (e) of the Revenue Act of 1936 a loss sustained from securities becoming worthless which

is deductible under that sub-section is deductible in full and against ordinary income. In contrast thereto a loss sustained from the sale or exchange of such securities as are capital assets is not only subject to reduction by the percentage brackets of Section 117 (a) of that Act but cannot be offset against ordinary income except to the extent of $2,000. This distinction in treatment is not satisfactory, since, in either case, the loss sustained by the taxpayer is a loss of capital and consequently should be treated similarly for tax purposes. This difference in treatment is eliminated by the bill. Section 23 (g) thereof, dealing with capital losses, subjects losses arising from stock or stock rights becoming worthless to the same limitations provided under Section 117 of the bill with respect to sales or exchanges.

"A similar difference exists in the treatment of losses sustained when bonds (which are capital assets) become uncollectible and so are deductible as bad debts under Section 23 (k) of the Revenue Act of 1936. This difference in treatment is also eliminated by the bill. Section 23 (k) thereof subjects losses arising from securities, as defined therein, becoming worthless, to the same limitations provided for under Section 117. Securities as defined in Section 23 (k) means bonds, debentures, notes, certificates, or other evidences of corporate indebtedness, with interest coupons or in registered form."

Had Congress intended by implication to amend Section 23 (k) of that Revenue Act in 1934, then it would not have been necessary in 1938, to amend that section, as was in fact done. *Fairbanks vs. U. S.*, supra. The very fact that Congress in a Revenue Act deals with a specific situation, indicates clearly that it intends to alter the law as it stood before such enactment. In other words, if it had been understood by Congress that Section 23 (k) of the Revenue Act of 1934 was, by implication, amended by the addition of Section 117 (f) to

that Revenue Act, then, indeed, the action of Congress in 1938 in specifically amending Section 23 (k) was merely an idle gesture. It cannot be thought that Congress would by specific amendment deal with a situation in exactly the same manner as Congress had intended that situation to be handled in prior legislation. The very fact of a change in 1938 indicates that Congress did not intend to amend Section 23 (k) in 1934. *Stewart v. United States*, 106 Fed. (2) 405, headnote 8:

> "Moreover, we have the Congress, by Section 817 of the Revenue Act of 1938, 52 Stat. 447, 578, 12 U. S. C. A. 1931a, expressly repealing or amending Section 26 of the Farm Loan Act by declaring 'all income, except interest, derived' from such bonds, shall be included in gross income. If such income was taxable despite Section 26 prior to the Revenue Act of 1938, what was the reason for Section 817 of the latter act? The answer is obvious—under the statutes that income was theretofore exempt. Cf. Brewster v. Gage, 280 U. S. 327, 337, 50 S. Ct. 115, 74 L. Ed. 457. In this Section 817 the Congress said what it could have said in 1916 or in 1928, or any year, but did not. The enactment of the act in 1938 was no idle gesture but was necessary to change the proper construction of the law as it stood prior thereto. 'This was the explicit and intelligible declaration to which the public was entitled * * *.' when the Congress decided to terminate the exemption theretofore granted. State of South Carolina ex rel. Wagner v. Stoll, 84 U. S. 425, 436, 17 Wall. 425, 21 L. Ed. 650. This was the specific amendment or repeal of Section 26 and the attempt to argue that the same result had already been accomplished by the Revenue Act of 1928 is futile."
> *Fairbanks v. United States, supra.*

It cannot be doubted that Congress intended by the Revenue Act of 1934 to deal exclusively with *retirement* of bonds, in the legal sense, and that it did not have in mind bonds be-

coming totally or partially uncollectible. This being true, the determination of the question here rests squarely upon the simple question of whether the meaning of the word "retirement" in the Revenue Act of 1934 can be stretched and distorted to include situations where a debtor becomes insolvent and its bondholders realizing that the full amount of the debt can never be paid receive payment of a part only of the face amount of the obligation.

II. PRIOR CASES TREATING THIS QUESTION

The only courts which have passed on this exact question are the Circuit Courts of Appeal for the Fifth and Eighth Circuits. The Fifth Circuit has had before it, in addition to the present case, the case of *Thomas v. Perkins*, 108 Fed. (2) 87. The Eighth Circuit has ruled on this question in the case of *S. C. Thomson v. Commissioner*, 108 Fed. (2) 642, which case is also before this court on certiorari.

The Fifth Circuit has not been consistent in its opinions for in the Thomas case when this question was presented, the result reached was exactly opposite to that reached in the present case.

Thomas v. Perkins, 108 Fed. (2) 87.

This was an action by Perkins and wife to recover income taxes allegedly illegally collected in the year 1935. Mr. Perkins had purchased Class B certificates of the Creditors' Committee of American Refining Company, Inc., at a cost of $185,333.05. When all the assets of the insolvent were liquidated by the committee, it paid to Mr. Perkins $32,283. He claimed a bad debt loss for the year 1935 of $153,030.15, being the difference between the amount paid and the amount

received. This claim was predicated upon Section 23 (k) of the Revenue Act of 1934.

The Commissioner of Internal Revenue disallowed the loss except for $2,000. One of the alternate theories for thus limiting the loss was that the certificates had been retired within the meaning of Section 117 (f) of the Revenue Act of 1934.

The Circuit Court in passing on this contention dismissed it with the following statement: Quoting from page 89:

> "Agreeing with appellee that the point is without merit, that no sort of strained construction of the invoked section will permit its application to appellee's certificates, and the payments on them, we pass to a consideration of the appellant's main point. * * *."

This ruling embraces the correct interpretation of Section 117 (f) as demonstrated in the first part of this brief.

In deciding the present case, the Circuit Court for the Fifth Circuit did not even mention the Thomas case, although it was called to the court's attention and thoroughly discussed in the brief and argument.

Since the *S. C. Thomson* (supra) case is now before this court it needs no discussion here. The case was correctly decided below and should be affirmed. The following quotation from that case aptly states the correct rule of law. Quoting from 108 Fed. (2), at page 643:

> "We are of opinion that what happened here may not fairly be taken as a 'retirement' of the petitioner's debentures. Dictionary definitions of 'retire' are 'to pay up and withdraw from circulation,' 'to withdraw from circulation or from the market,' 'to take up or pay.' The word signifies some voluntary action on the debtor's

part *in fulfillment of his promise to pay*. A man as sanguine as Micawber might describe his bankruptcy as a 'retirement' of his obligations, but a merchant seeking credit who spoke in such euphemisms might find himself in trouble later. Where creditors receive a petty dividend (one-half of one per cent in this case) on the collapse of their debtor, their claims may be extinguished but are hardly 'retired.' The Board was in error in treating the case as one of 'retirement' of the petitioner's debentures."

Although counsel in the Thomson case, in their brief in opposition to certiorari sought to distinguish the "McClain" case, no such distinction is tenable.

Insolvency of the debtor exists in both cases. Partial worthlessness of the obligation exists in both cases. An actual pecuniary loss exists in both cases. The facts of the two cases are identical except for the fact that a receiver was appointed for the debtor in the Thomson case, and the assets were liquidated and distributed through the receivership.

In the case of Mr. McClain, his debtor attempted bankruptcy and failed. The fact of attempted bankruptcy plus the findings of the Reconstruction Finance Corporation conclusively demonstrated insolvency at the time this transaction took place. Mr. McClain had two alternatives in the matter: (a) recognize the impossibility of the situation and salvage what he could, or (b) institute expensive litigation to foreclose and spend his remaining value in attorneys' fees and court costs. The practical result in both cases would have been the same, except in the amount ultimately received. Being practical and sensible, the alternative was adopted which would salvage the most from the wreckage.

This court has consistently and frequently announced that taxation is a practical problem to be approached in a prac-

tical manner and legal casuitries and intricacies to be avoided. Practically approached the Thomas, Thomson and McClain cases present the same questions.

> "Taxes are very real things and statutes imposing them are estimated by practical results."

Nichols vs. Coolidge, 274 U. S. 531 at 541; 47 Sup. Ct. 710. Cf. *Helvering v. Hallock*, 309 U. S. 106, 60 S. Ct. 444, 84 L. Ed. advop. 382.

Respectfully submitted,

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APPENDIX

Section 23 (k) of the Revenue Act of 1934:

"Bad debts.—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction."

Section 117 (f) of the Revenue Act of 1934:

"Retirement of bonds, etc.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

Regulation 86, Article 23 (k) 4, Revenue Act of 1934:

"Worthless bonds and similar obligations.—Bonds, if ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year."

Section 23 (k) (2) and (3) of the Revenue Act of 1938:

"Securities Becoming Worthless.—If any securities (as defined in paragraph (3) of this subsection) are ascertained to be worthless and charged off within the taxable year and are captal assets, the loss resulting therefrom shall, in the case of a taxpayer other than a bank, as defined in section 104, for the purposes of this title, be considered as a loss from the sale or exchange, on the last day of such taxable year, as capital assets.

"Definition of Securities.—As used in this subsection the term 'securities' means bonds, debentures, notes, or certificates, or other evidences of indebtedness, issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form."

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In the Supreme Court of the United States

OCTOBER TERM, 1939

DONALD S. MCCLAIN, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF AND ARGUMENT FOR THE RESPONDENT

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. 914

DONALD S. McCLAIN, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

The Government has filed a petition for certiorari in *Helvering* v. *Thomson,* No. 946, present Term, in which a conflict with the present case is asserted. If certiorari is granted in the *Thomson* case, then obviously the petition should be granted here. Otherwise, the petition should be denied.

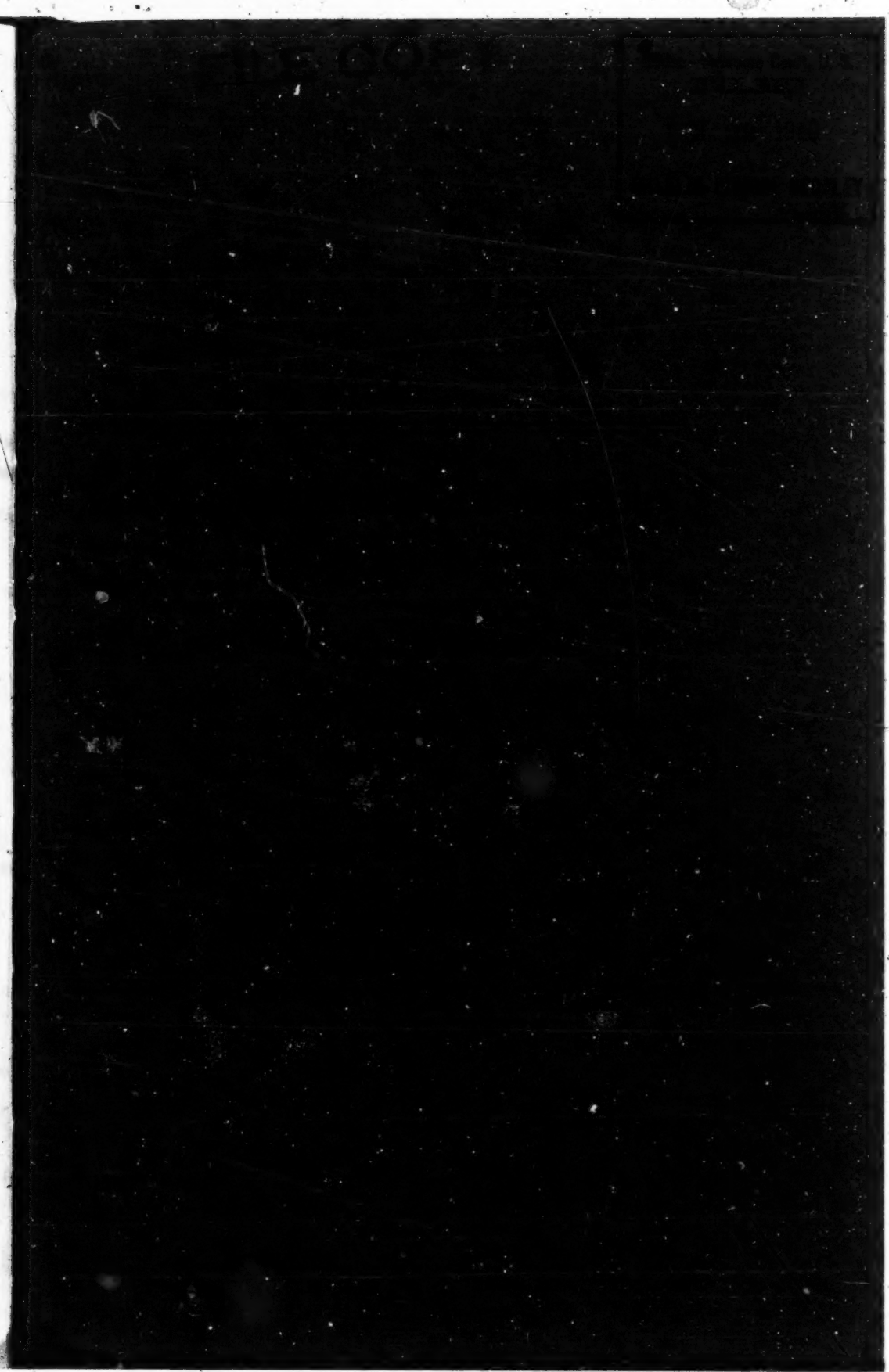
Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.

APRIL 1940.

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 55

DONALD S. McCLAIN, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 19–21) is unreported. The opinion of the Circuit Court of Appeals (R. 29–31) is reported in 110 F. (2d) 878.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 23, 1940 (R. 31). The petition for a writ of certiorari was filed April 15, 1940, and was granted May 20, 1940 (R. 34). The jurisdiction of this Court rests upon Section 240 (a) of the

Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer held bonds of a water improvement district, a political subdivision of the State of Texas. The district became unable to pay the principal and interest on its bonds and as a condition to its obtaining a loan so that it might continue its operations the bondholders agreed to surrender their bonds and accept 49.9% of their face value in satisfaction of them.

The question presented is whether the deduction of the resulting loss is subject to the limitations upon capital losses contained in Section 117 (d) of the Revenue Act of 1934. The answer to this question in turn depends upon whether there was a "retirement" of the bonds within the meaning of Section 117 (f).

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations involved will be found in the Appendix, *infra*, pp. 38–41.

STATEMENT

The facts as stipulated (R. 14–19) and as found by the Board of Tax Appeals in its memorandum opinion (R. 19–21) are substantially as follows:

The taxpayer is a resident of Atlanta, Georgia (R. 14). In 1918 the taxpayer received as a gift from his father bonds of the Cameron County Water Improvement District Number Two, Cam-

eron County, Texas, a political subdivision of the State of Texas. The bonds had a par value of $15,000, and their value at the time of the gift was $15,000 (R. 14–15, 20).

The bonds were held for profit by the taxpayer but not in connection with his trade or business (R. 17).

In 1935 the District, being unable to pay the interest or principal of its bonds, had sought the benefits of the Municipal Bankruptcy Act, but the Act was declared unconstitutional by this Court. Thereupon, the District made application to the Reconstruction Finance Corporation for a refunding loan which the Reconstruction Finance Corporation granted in an amount sufficient to enable the District to pay 49.9¢ per dollar on the principal of the bonds held by the taxpayer and others, the payment to be made from the proceeds of the loan obtained by the District (R. 15, 20).

At the time of the loan, conditions had become very bad in Texas; landowners in the state were unable to pay their taxes, and the District was in default on both the principal and interest of the bonds. The District sought a loan of $300,000, but the Reconstruction Finance Corporation, on January 6, 1935, adopted a resolution authorizing a loan of only $264,500, to be secured by the assets of the District. It had determined after an appraisal that 49.9¢ on the dollar of principal was the maximum amount which the District could pay

in view of its current liabilities and charges (R. 15–16).

In authorizing the loan the Reconstruction Finance Corporation imposed the following conditions (R. 16–17):

> *Deposit of old securities.*—The holders of Old Securities who join in this plan of refinancing shall deposit the same with one or more committees, depositaries, or other responsible representatives satisfactory to them, which shall consent to the plan of refinancing contemplated by this resolution (hereinafter referred to as "Owners' Agents"), or shall otherwise give this Corporation satisfactory assurances that the Old Securities held by them will be subjected to such plan, in which latter case they are hereinafter referred to as "consenting owners." Old Securities deposited with Owners' Agents or held by consenting owners are hereinafter referred to as "Deposited Securities." Each Owners' Agent shall be duly authorized to receive all moneys payable to the holders of Old Securities deposited with it, to surrender the Deposited Securities and do all other acts and things necessary to enable the District to effect a reduction in its indebtedness to the extent and in the manner contemplated by this resolution.
>
> No loan shall be made hereunder (a) unless all of the Old Securities shall be thus deposited or (b) unless the Division Chief

> shall deem that such a large proportion of such securities has been deposited as will satisfactorily accomplish the purposes of this Corporation in authorizing this loan. In this latter event, as hereinafter more fully provided, lesser amounts may be payable on the Deposited Securities than in case all of the Old Securities are deposited.

The taxpayer consented to the plan of refinancing, forwarded his bonds to a bank in Texas, and upon the receipt of 49.9¢ on the dollar the bonds were delivered over to the bank as agent for the District to be cancelled (R. 17, 20).

It was the understanding of the taxpayer and all other bondholders thus surrendering their bonds that the amount of 49.9¢ on the dollar so received on account of the principal was the final and the only amount which they would receive on the bonds, although there was no writing to evidence this nor any agreement between the District and the bondholders to that effect (R. 17–18).

During 1935 the taxpayer wrote off his books as uncollectible the difference between $15,000, the value of the bonds on the date of their gift to him, and the amount received from the District, $7,476.75. In his return for 1935 he claimed a deduction of $7,523.25 as a bad debt (R. 18, 20).

The Commissioner determined that the transaction constituted a "retirement" of the bonds within the meaning of Section 117 (f), disallowed the de-

duction for a bad debt, and limited a deduction for a loss under Section 117 to $2,000.[1] On the basis of this and another adjustment not here involved he determined a deficiency of $1,034.25 (R. 8–12, 18, 19).

The Board of Tax Appeals sustained the Commissioner's determination and the Circuit Court of Appeals affirmed the Board's decision.

SUMMARY OF ARGUMENT

The narrow question involved in this case is whether the cash received by the taxpayer, upon the surrender at the invitation of the debtor, of his water improvement district bonds in consideration of the receipt of 49.9% of their face value was an amount received "upon retirement" of the obligations within the meaning of Section 117 (f) of the Revenue Act of 1934. If it was, Section 117 (f) requires that the amount be treated as having been received in exchange for the bonds, with

[1] It is not entirely clear whether or not the taxpayer had other capital losses which had already been allowed to the extent of his capital gains plus $2,000 or whether this was his only loss. The deficiency letter shows a disallowance of the total amount of $7,523.25 (R. 9) but also states that the $2,000 amount has already been allowed (R. 11). The stipulation (R. 18) and the Board's memorandum opinion (R. 20) indicate that he had no other capital losses and that $2,000 of the $7,523.25 loss was allowed. We have accepted the facts as stated in the stipulation and the Board's memorandum opinion, but in any event the parties have agreed that the deficiency was correctly determined if the loss is to be treated as a capital loss.

the consequence that the loss is a capital loss which may be deducted only in accordance with the limitations of Section 117 (a) and 117 (d).

The provisions of Section 117 (f) must necessarily be construed in the light of the Congressional purpose to stabilize the revenue by limiting the extent to which capital losses might be used to offset ordinary income. Congress sought to accomplish this purpose in two ways: (1), by changing the method of dealing with capital gains and losses, and (2), by expanding the operation of the capital gain and loss provisions to include transactions which were not strictly sales or exchanges of capital assets.

Section 117 (f) provides in substance that for the purpose of the income tax title amounts received by the holder upon the "retirement" of bonds or similar evidences of indebtedness issued by corporations, Governments, or political subdivisions, if such obligations constitute capital assets, shall be considered as amounts received in exchange therefor.

The word "retirement" must be taken to have been used in its ordinary sense in Section 117 (f). The verb "retire" has been defined as meaning "to withdraw from circulation, to take up and pay." There was a retirement of the bonds in this case, since they were taken up and paid and withdrawn from circulation when the taxpayer agreed to accept and did accept less than their face value in exchange for them.

The word "retirement" is a broader term than "redemption," which has been defined as meaning the payment of an obligation according to its terms, and the legislative history shows that the Congressional choice of the word "retirement" rather than the word "redemption" was deliberate. Hence the statute cannot be said to apply only to cases where bonds are redeemed in accordance with their terms either at maturity or pursuant to an authorized call prior to maturity.

Nor can the application of the statute be held to depend upon whether or not the retirement of the obligations was a voluntary or involuntary act on the part of the debtor.

The language of the statute suggests no such limitation and the purpose of Congress would not be served if the statute were so confined. The statute should be construed as applying to all situations where there is a surrender of the obligations to the debtor or some one standing in the position of the debtor for cash, whether in pursuance of the original contract or otherwise. From the bondholder's standpoint, all of such transactions have the practical consequences of a sale or exchange, and Congress undoubtedly meant to bring all of them under Section 117 (f).

This conclusion is fortified by the fact that when Congress enacted Section 23 (k) (2) of the Revenue Act of 1938, it brought within the operation of the gain and loss provisions a third class of cases,

namely, situations where the obligations are retained but have become totally worthless. It must have considered that a loss such as the one here involved already came under Section 117 (f), which remained unchanged in the Revenue Act of 1938.

The fact that under earlier statutes a loss such as the one here involved might have been deducted as a bad debt or that, but for Section 117 (f), it might be deducted as a bad debt under Section 23 (k) is immaterial. The bad debt provisions are general provisions relating to all classes of bad debts, whereas Section 117 (f) relates specifically to a retirement of bonds. A specific provision prevails over a general provision which might otherwise apply, and if this case comes under Section 117 (f), Section 23 (k) has no application.

ARGUMENT

THE TAXPAYER'S SURRENDER OF HIS BONDS FOR CASH CONSTITUTED A RETIREMENT OF THE OBLIGATIONS WITHIN THE MEANING OF SECTION 117 (f) AND THE LOSS THEREBY SUSTAINED WAS A CAPITAL LOSS

A. *Introductory*

The narrow question involved in this case is whether the cash received by the taxpayer upon the surrender, at the invitation of the debtor, of his water improvement district bonds in consideration of the receipt of 49.9% of their face value was an amount received "upon retirement" of the obligations within the meaning of Section 117 (f) of the

Revenue Act of 1934. If it was, Section 117 (f) requires that the amount be treated as having been received in exchange for the bonds, and his loss is regarded as a capital loss, which under Section 117 (a) may be taken into account only to the extent of 30% since the bonds had been held for more than ten years, and which under Section 117 (d) may, with any other capital losses, be deducted only to the extent of his capital gains plus $2,000. If it was not such a retirement, the Government concedes that the difference between the basis and the amount received may be deducted as a bad debt under Section 23 (k).

Before dealing with the precise question here involved, however, it will be helpful to consider the scope and purpose of Section 117 as a whole and the historical background of that section, which was enacted for the first time in 1934.

Section 117 represented a new and different method of dealing with gains and losses arising from the sale or exchange of capital assets. It not only brought within the scope of the operation of the capital gain and loss provisions transactions which had not theretofore been treated as sales or exchanges of capital assets but changed fundamentally the method of dealing with all capital gains and losses. One of the purposes of these changes was, as we shall subsequently point out, that of stabilizing the revenue, an objective toward which Congress had been working over a period of years.

The first statute that dealt comprehensively with capital gains and losses was the Revenue Act of 1924. Section 206 of the Revenue Act of 1921, c. 136, 42 Stat. 227, however, had contained special provisions with reference to capital net gains (defined as meaning the excess of capital gains over capital losses and capital deductions) and had provided that a taxpayer might elect to be taxed on his capital net gains at 12½% instead of at the ordinary normal and surtax rates, provided that in no case should the total tax be less than the 12½% of the total net income. The provision applied only to gains arising from "a sale or exchange of capital assets" which were defined generally as meaning property acquired and held for profit or for investment for more than two years. The purpose of this provision was to increase the revenue by encouraging the sale of assets held for a period of years which might otherwise remain unsold on account of the fear of the imposition of a prohibitive tax. See *Burnet* v. *Harmel,* 287 U. S. 103; H. Rep. No. 350, 67th Cong., 1st Sess., p. 10; S. Rep. No. 275, 67th Cong., 1st Sess., p. 12, H. Rep. No. 486, 67th Cong., 1st Sess., p. 20. No special treatment for capital losses was provided for in this statute

Under Section 208 of the Revenue Act of 1924, c. 234, 43 Stat. 253, a taxpayer who had sustained a capital net gain was again given an election to have the tax thereon computed at the 12½% rate instead of at the ordinary rates, and the limitation

on the amount of the tax that had existed under the earlier statute was eliminated. At the same time special treatment was accorded to capital net losses. Section 208 (c) had the effect of making the taxpayer pay the greater of the following taxes: (1) The tax computed by allowing the capital net loss as an ordinary deduction, and (2) the tax determined by allowing 12½% of the capital net loss to be deducted from the tax computed on the ordinary net income without the allowance of such a deduction. The purpose of these provisions was stated to be that of equalizing the treatment accorded to capital net losses and capital net gains (H. Rep. No. 179, 68th Cong., 1st Sess., pp. 19–20) but it obviously had the effect of limiting the extent to which a taxpayer could reduce the tax on his ordinary income by making use of capital losses. See *United States* v. *Pleasants,* 305 U. S. 357, 360.

Section 208 of the Revenue Act of 1926, c. 27, 44 Stat. 9, and Section 101 of the Revenue Act of 1928, c. 852, 42 Stat. 791, made few changes in the capital net gain and capital net loss provisions of the Revenue Act of 1924.[2]

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[2] They did, however, enlarge the definition of the term "capital assets" by providing that in certain cases where the taxpayer had acquired the property in a nontaxable exchange or as the result of a transaction which required him to use the transferor's base in measuring gain or loss the period that the exchanged property had been held or that the transferor had held the property was to be added in determining whether the two-year requirement was satisfied.

Section 101 of the Revenue Act of 1932, c. 209, 47 Stat. 169, did not make any substantial changes in the treatment accorded to capital net gains and capital net losses, but Section 23 (r) imposed certain limitations on the deduction of losses from the sale or exchange of stocks and bonds which were not capital assets as defined in Section 101. Section 23 (r) provided that except in the case of banks and dealers in securities losses from such sales should be deducted only to the extent of capital gains from similar sales, though under certain limitations, however, losses of that character disallowed in one taxable year could be applied against gains from the sale of noncapital assets in the succeeding year. The purpose of Section 23 (r) was that of protecting the revenue by preventing the practice of using losses on security transactions to reduce taxes and of preventing speculative losses from wiping out ordinary income. H. Rep. No. 708, 72d Cong., 1st Sess., pp. 12–14; S. Rep. No. 665, 72d Cong., 1st Sess., pp. 10, 17–18; H. Rep. No. 1492, 72d Cong., 1st Sess., p. 12. The provision was made more comprehensive by Section 23 (s) which provided that gains or losses from short sales of stocks and bonds or from privileges or options to buy or sell securities

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These were merely changes designed to correlate different sections of the statute (see H. Rep. No. 1, 69th Cong., 1st Sess., pp. 6–7) but insofar as they applied to capital losses they imposed further limitations on the reduction of taxes by means of losses on the sale or exchange of capital assets.

should be treated as gains or losses from the sale of such securities.

There were other provisions enacted during the period 1921–1934 which were also designed to stabilize the revenue by limiting the impact of capital gains and losses upon ordinary income. For instance, Section 214 (a) (5) of the Revenue Acts of 1921, 1924, and 1926 had prohibited the deduction of losses on the sale of securities where substantially identical securities were purchased within thirty days. See also Section 118 of the Revenue Acts of 1928, 1932, and 1934.

In enacting the Revenue Act of 1934, Congress showed unmistakable evidence of its desire to lessen further the effect upon the revenue of the recognition of capital losses. For instance, Section 24 (a) (6) prohibited the deduction of losses from sales and exchanges of property directly or indirectly between members of a family and, except in the case of a liquidation, between an individual and a corporation in which he and his family owned more than 50% of the stock. Section 23 (g) provided that losses from wagering transactions could be deducted only to the extent of gains from such transactions.

But more important innovations were made in Section 117. That section does not, as do previous statutes, provide for a separate computation of the tax on capital gains and losses, but rather imposes limitations on the extent to which such gains and

losses can be taken into account in computing net income. Section 117 (a), which is applicable only to individuals, provides that only certain percentages of the capital gains shall be taken into account depending upon the length of time that the asset has been held. The percentage ranges from 100% where the asset had been held for not more than one year to 30% where the asset has been held for more than ten years.[3] Section 117 (d), which is made applicable to corporations as well as individuals, provides that capital losses shall be deducted only to the extent of capital gains plus $2,000. Under previous statutes, the capital gain and loss provisions had not applied to corporations. One of the purposes of these limitations, particularly of Section 117 (d), was that of achieving more stability in the revenues by preventing capital losses from being offset against ordinary income. See H. Rep. No. 704, 73d Cong., 2d Sess., pp. 9–10, 30–32, and the statement on the Senate Floor by Chairman Harrison of the Senate Finance Committee (Cong. Record, Vol. 78, Part 6, p. 5846).

As a part of the same general purpose Congress

[3] Section 117 (c) lays down certain rules for determining how long an asset has been held for the purpose of applying this section, which rules are taken from the definition of capital assets in previous laws which had defined the term as meaning property held by the taxpayer for more than two years (see Section 101 of the Revenue Act of 1932). In this statute, the term "capital assets" is defined simply as meaning property held by the taxpayer with certain limitations. See Section 117 (b).

sought to bring certain transactions which might not normally be regarded as constituting sales or exchanges within the operation of the statute. To that end it provided in Section 117 (f) that amounts received upon the retirement of bonds or other evidences of indebtedness issued by a corporation or a Government, or one of its subdivisions, should be treated as having been received in exchange therefor.

The enactment of this provision followed the decisions of the Board of Tax Appeals in *Watson* v. *Commissioner,* 27 B. T. A. 463 (decided in December, 1932, and *Braun* v. *Commissioner,* 29 B. T. A. 1161 (decided in February 1934),[4] holding that payments of the amount specified in a bond either at maturity or pursuant to an authorized call prior to maturity did not constitute a sale or exchange. This Court subsequently reached the same conclusion in *Fairbanks* v. *United States,* 306 U. S. 436, but that case had not then been decided either by this Court or the lower courts.

The broadening of the scope of Section 117 was to be carried still further under the Revenue Act of 1938, by provisions hereinafter referred to, but so far as pertinent here, the vital step was taken by the enactment of Section 117 (f) of the Revenue Act of 1934 (Appendix, *infra,* p. 40). The language of that provision must necessarily be con-

[4] These decisions overruled the decision of the Board in *Werner* v. *Commissioner,* 15 B. T. A. 482, which had held to the contrary.

strued in the light of this history of the earlier statutes and of a recognition that the purpose of Congress in enacting it was that of stabilizing the revenue and of expanding the operation of the capital gain and loss provisions.

B. Section 117 (f) covers all transactions whereby bonds or other evidences of indebtedness of a corporation or of a government are surrendered for cash and the debt is thereby extinguished

Section 117 (f) provides as follows:

> (f) *Retirement of bonds, etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

The above-quoted provision is very broad. It applies to all bonds, debentures, notes, certificates, or other evidences of indebtedness issued by a corporation or by a government or political subdivision thereof with interest coupons or in registered form, and provides without exception that all amounts received by the holder of such obligations upon their retirement shall be considered as received in exchange therefor. A transaction by which a creditor at the invitation of his debtor surrenders his bonds for an amount less than their

face value would clearly seem to be the type of transaction which Congress would have wished to reach if its purpose was to bring within the operation of capital gain and loss provisions dispositions of bonds for cash which were not sales or exchanges, but which had a similar effect. It must indeed have had precisely this type of transaction in mind, for the year 1934 was a year of financial difficulties when many readjustments of debt were taking place, and to achieve its declared purpose of stabilizing the revenues, it was necessary to legislate with reference to those adjustments.

The taxpayer's whole argument that Section 117 (f) does not apply to his case is based upon the construction which he places upon the word "retirement." He argues that a "retirement" of securities means the payment of an obligation in full at maturity and does not have any reference to the compromising of corporate obligations or an incomplete or partial payment thereof. He argues further that Congress intended only to meet cases like the *Watson case, supra,* where it had been held that a loss upon the redemption of bonds was not a capital loss.

We submit that the court below properly construed the word "retirement" as being applicable to a situation where securities at the invitation of the debtor are taken up for an amount less than their face value and withdrawn from circulation. See also *Corbin* v. *Commissioner,* 39 B. T. A. 1163.

Neither the word "retirement," which means merely the "act of retiring" (Webster's New International Dictionary), nor the verb "retire" are words of art. The latter is defined in Webster's New International Dictionary (1939 Ed.), p. 2128, as meaning, among other things, "To withdraw from circulation, or from the market; to take up or pay; as, to *retire* bonds; to *retire* a note." The Century Dictionary and Cyclopedia (Revised Ed.), Vol. VIII, p. 5123, defines "retire" as meaning "To recover; redeem; regain by the payment of a sum of money; * * *." In the absence of any evidence that retirement was used in a peculiar sense in Section 117 (f) it must be given its ordinary meaning (*Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552; *Woolford Realty Co.* v. *Rose,* 286 U. S. 319; *Old Colony Co.* v. *Commissioner,* 301 U. S. 379), and there was a retirement of the bonds in this case, since they were taken up and paid and withdrawn from circulation when the taxpayer agreed to accept and did accept less than their face value in exchange therefor.

The taxpayer in substance argues that the word "retire" has the same meaning as "redeem." But that is not the case. The word "redeem" has been defined as meaning the "payment of an obligation according to its terms." *United States* v. *Fairbanks,* 95 F. (2d) 794, 796 (C. C. A. 9th), affirmed, 306 U. S. 436; *Watson* v. *Commissioner,* 27 B. T. A. 463; *Braun* v. *Commissioner,* 29 B. T. A. 1161. See

also *Felin* v. *Kyle*, 102 F. (2d) 349 (C. C. A. 3d). If the word "redemption" had been used in the statute there might have been some basis for the taxpayer's argument that Section 117 (f) does not apply. But the statute employs the term "retirement" and not the term "redemption"; and while a retirement undoubtedly includes a redemption, it is a broader term and may apply to transactions by which bonds or other evidences of debt are surrendered for cash and cancelled, even though they are not discharged in accordance with the terms of the original contract but in accordance with an independent agreement.[5] In *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, upholding the validity of a regulation which provided that if a corporation purchases and retires any of its bonds at a price less than the issuing price, it realizes a gain, the word "retire" was used in the sense of a cancellation or withdrawal from circulation. See also Section 23 (r) (1) of the Revenue Act of 1932 providing that losses on the sale or exchange of non-capital assets are deductible only to the extent of gains derived from similar transactions, including

[5] That the two words are not the same is suggested by the fact that both are used under the reorganization provisions of the Bankruptcy Act in such manner as to indicate that Congress believed them to have different contents. See Act of June 22, 1938, c. 575, 52 Stat. 840, 895–897, amending Section 216 (12) (b) of the Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended.

gains derived by the taxpayer from the retirement of his own obligations.

If, as the taxpayer contends, the purpose of Congress had been merely to reach situations such as the one involved in the *Watson* case, where there was a discharge of the obligation in accordance with the terms of the contract, it would no doubt have used the word "redemption," which would fit such a case. In choosing a broader and less restricted term it must have had in mind other transactions. This conclusion is strengthened by the fact that the legislative history of the provision shows that the choice of the word was deliberate. The Committee on Federal Taxation of the American Bar Association had recommended to the Committee on Ways and Means of the House that the existing law be amended to make it clear that the definition of capital gains and losses include gains and losses arising from the redemption of capital assets. House Hearings before the Committee on Ways and Means on Revenue Revision, 1934, 73d Cong., 2d Sess., pp. 190–191. But Congress chose another word.

The decision of the Circuit Court of Appeals for the Second Circuit in the case of *Thomson* v. *Commissioner*, 108 F. (2d) 642, now pending before this Court, No. 58, October Term, 1940, upon which the petitioner relies, did not directly hold that Section 117 (f) applies only to a redemption of securi-

ties, though the court unduly restricted the meaning of the word "retirement" and held that there was not a retirement of the debentures there involved, but an "extinguishment" where they were surrendered for a small sum in the course of receivership. The court there apparently drew a distinction between voluntary and involuntary transactions and held that a retirement referred only to a transaction which was voluntary on the part of the debtor and that in the case of an involuntary transaction there was merely an extinguishment of the debt which gave rise to a bad debt deduction. It also apparently attached some importance to the fact that only a small proportion of the face value of the bonds was received upon their surrender.

In our briefs in *Commissioner* v. *Hammel,* No. 49, October Term, 1940, and *Electro-Chemical Engraving Co., Inc.* v. *Commissioner,* No. 62, October Term, 1940, the Government is arguing that Section 117 applies to losses sustained through the foreclosure sale of property, even though the transaction is involuntary. If that is the proper construction of the general provisions of Section 117, there is no reason to suppose that Section 117 (f) is more limited. But even if the Court should hold that a sale implies a voluntary transaction in those cases, such conclusion would afford no justification for the view that whether or not a bondholder has had his bonds retired and thus incurred a capital

loss depends upon whether or not the transaction was voluntary or involuntary. That such a distinction is artificial is illustrated by the facts in this case, where the water improvement district and the bondholders had no choice except the course which they pursued. The district was insolvent; it could not legally declare itself a bankrupt; it had no means of paying its obligations; it was obliged to cons[illegible] to the terms which the Reconstruction Finance [illegible]poration imposed in granting the loan, and the bondholders were obliged to accept the district's terms, which called for a surrender of the bonds and the payment of 49.9% of their face value. Yet, technically perhaps, the transaction was a voluntary one and, if so, would, according to the reasoning of the court in the *Thomson* case, come under Section 117 (f), whereas in the *Thomson* case, where the transaction was technically involuntary, the provision would not apply. Such a distinction between the two cases seems artificial and unreal since the taxpayer-bondholder has sustained precisely the same kind of loss in the two cases. Moreover, the legislative history of the provision indicates that Congress had no such distinctions in mind.

There are three types of situations in which the taxpayer may realize a loss upon the evidences of indebtedness of a corporation or of a government, namely, (1) a disposition of the securities by a sale or exchange which involves a transaction with a

third person, (2) a surrender of the securities to the debtor or someone standing in the position of the debtor for cash, and (3) the securities becoming worthless, which does not involve any transaction with anyone. The first two of these situations, but not the third, could also give rise to a gain.

Under the statutes prior to 1934, only the first situation, namely, a disposition of the securities by a sale or exchange, was covered by the capital gain and loss provisions. In *Fairbanks* v. *United States*, 306 U. S. 436, this Court held that the payment and discharge of a bond in accordance with its terms, whether at maturity or pursuant to an authorized call prior to maturity, was not a sale or exchange. See also *Watson* v. *Commissioner*, 27 B. T. A. 463; *Felin* v. *Kyle*, 102 F. (2d) 349 (C. C. A. 3d). It was also held that a compromise with the maker of a promissory note for less than its full value was not a sale or exchange. *Hale* v. *Helvering*, 85 F. (2d) 819 (App. D. C.). Though that case did not involve corporate securities, presumably the same rule would apply in such a case. In other words, the only transaction which was regarded as constituting a sale or exchange was a transaction by which the bond or other evidence of indebtedness was transferred to a third person for a consideration. If was held that where the transaction involved the creditor and debtor only, there was merely a payment and discharge of the debt in whole or in part and not a sale or exchange. See

Felin v. *Kyle, supra; Bingham* v. *Commissioner,* 105 F. (2d) 971 (C. C. A. 2d); *Buell* v. *Commissioner,* 106 F. (2d) 398 (C. C. A. 10th). See also *Averill* v. *Commissioner,* 101 F. (2d) 644 (C. C. A. 1st), where the court recognized this distinction, but nevertheless held that a redemption of bonds should be regarded as a sale or exchange.

It is obvious that from the point of view of taxation there had never been any reason, apart from the controlling language of the statute, for treating differently the various types of losses which a taxpayer sustains on investments in corporate and governmental bonds or other evidences of indebtedness. The practical consequences to the bondholder are the same whether his loss is sustained (1) by selling the bonds to a third person, (2) by surrendering them for cash to his debtor, or some one standing in the debtor's position, whether in pursuance of the original contract or otherwise, or (3) by having them become worthless on his hands. The second situation, however, more closely resembles a sale than does the third, since in both cash is received and the securities are disposed of. In the third class the securities are retained, but their value is irretrievably gone so that they cannot be sold or otherwise disposed of.

It is our position that when Congress enacted Section 117 (f) it intended to cover all transactions coming within the second class, namely, all cases in which the taxpayer disposed of his securities for

cash otherwise than by a transaction with a third person. It is logical to assume that that was its intention because of the resemblance which these transactions bore to a sale or exchange and because of the language of the statute itself, which requires that "amounts received upon the retirement" of such obligations shall be treated as having been received in exchange therefor. In no case where the creditor surrenders his obligations to his debtor for cash is the obligation actually exchanged for the cash; rather the obligation is extinguished. See *United States* v. *Fairbanks, supra.* Hence, if Congress meant to treat one case of this type as an exchange, it undoubtedly meant to include all, regardless of whether the obligation was redeemed in accordance with its terms, as in the *Fairbanks* case, was surrendered in pursuance of an independent agreement with the debtor as here, or was surrendered in the course of a receivership or bankruptcy proceeding as in the *Thomson* case. The sole requirement was that there should be a retirement, that is, a cancellation, and that consideration should be received upon such a retirement.

This conclusion is strengthened by the fact that when Congress enacted the Revenue Act of 1938 it took care of the third class of cases, namely, cases where securities are retained but have become worthless. Section 23 (k) (2) of that Act provides that if securities (defined as including bonds, debentures, notes, certificates, or other evidences of

indebtedness issued by a private corporation or a government with interest coupons or in registered form) are ascertained to be worthless and charged off within the taxable year and are capital assets, the loss resulting therefrom shall, except in the case of a bank, be considered as a loss arising from an exchange or a sale.

Congress undoubtedly thought that by the enactment of this provision it had enacted the final provision necessary to achieve a uniform treatment of all losses arising from investments in corporate securities. In that connection it should be pointed out that amounts received by stockholders on the liquidation of corporations were already treated as being received from a sale or exchange of capital assets (see *White* v. *United States,* 305 U. S. 281, and *Helvering* v. *Weaver Co.,* 305 U. S. 293), and that in Section 23 (g) (2) of the Revenue Act of 1938 Congress took the final step with reference to losses on stock investments when it brought within the operation of capital gain and loss provisions losses sustained when stocks became worthless.

The taxpayer may argue that the transaction here involved is one which, if it had occurred in 1938, would fall under Section 23 (k) (2) of the Revenue Act of 1938 rather than under Section 117 (f) of that Act (which is identical with Section 117 (f) of the Revenue Act of 1934) and, hence, that in 1934 there was no provision which covered it. But Section 23 (k) (2), relating to

worthless bonds and similar evidences of indebtedness, and Section 23 (g) (2), relating to worthless stocks, both referred to situations where there was no disposition of the securities and nothing was or could be received from them—that is, to securities which become totally worthless. See *White* v. *United States,* 305 U. S. 281. The legislative history of those two sections supports that view. See H. Conference Rep. No. 2330, on the Revenue Bill of 1938, 75th Cong., 3d Sess., p. 35. See also Report of Subcommittee of the Committee on Ways and Means on a Proposed Revision of the Revenue Laws, 75th Cong., 3d Sess., pp. 44–46. The Treasury Department has consistently construed Section 23 (k) (2) as being applicable only to cases where the securities have become totally worthless. See Article 23 (k)–4 of Regulations 101, promulgated under the Revenue Act of 1938. The provision was not designed to cover a transaction in which bonds were surrendered in consideration of the receipt of cash, whether in a receivership as in the *Thomson* case or in the course of a refinancing as here. Those transactions were either covered by Section 117 (f) or were not covered by any provision,[6] which seems an unreasonable assumption. Congress must, therefore, have intended Section 117 (f) to apply to such cases.

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[6] Under the Revenue Act of 1938 no deduction may be claimed under Section 23 (k) (1) for bonds or similar evidences of indebtedness which are ascertained to be worthless in whole or in part. Such debts are expressly excluded from the operation of the general provisions relating to bad debts.

In *White* v. *United States*, 305 U. S. 281, 292, the Court considered the closely analogous situation where a stockholder receives a relatively negligible amount upon liquidation of his corporation. The Court pointed out that the resulting loss would be a capital loss subject to the limitations of Section 101 of the Revenue Act of 1928, notwithstanding the taxpayer's contention that had he received nothing at all upon liquidation he would have been entitled to much greater tax benefits through the deduction for worthless stock.[7] The possible harsh results that might flow from such apparent discrimination was not considered sufficient to depart from the plain language of the statute. The Court also pointed out that even though Section 23 (g) (2) of the subsequently enacted Revenue Act of 1938 provided that the loss upon worthless stock should be treated as a capital loss, the contrary result nevertheless continued for prior years. 305 U. S. at 292.

Similarly, there is a distinction under the Revenue Act of 1938 between transactions coming under Section 23 (k) (2) and those coming under Section 117 (f), though under that Act both are brought under the operation of the capital gain and loss provisions. Hence, under that statute the transaction here involved, and that involved in the *Thomson* case, would be treated as a loss from an exchange of capital assets by virtue of Section 117 (f) and not by virtue of Section 23 (k) (2).

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[7] A similar result was reached in *Echols* v. *Commissioner*, 61 F. (2d) 191 (C. C. A. 8th).

It follows that under Section 117 (f) of the Revenue Act of 1934, which is identical with Section 117 (f) of the Revenue Act of 1938, the amounts received by the taxpayer upon the surrender of his bonds for cash are to be regarded as having been received in exchange therefor and accordingly are subject to the limitations of Section 117 (d).

C. *A transaction coming under Section 117 (f) cannot be treated as giving rise to a bad-debt deduction under Section 23 (k) of the Revenue Act of 1934*

The taxpayer argues that bonds have always been regarded as debts and that when ascertained to be worthless in whole or in part and charged off have been deductible as bad debts. It is further claimed that amounts lost in a composition with an insolvent debtor have been permitted to be deducted as bad debts determined to be worthless in part. It is argued that since Section 23 (k) of the Revenue Act of 1934 is similar to the bad-debt provisions of the earlier statutes, it must likewise be construed as being applicable to such cases and that Section 117 (f) must be construed as applying only to a situation where bonds are called in and paid at par, where the loss has been treated as a loss and not a bad debt.

Section 23 (k) of the Revenue Act of 1934 (Appendix, *infra*, p. 38) provides for the deduction of debts ascertained to be worthless and charged off

during the taxable year and provides further that when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year as a deduction. The Government does not deny that bonds have been treated as debts within the meaning of similar bad-debt provisions of the previous revenue acts (*Pacific Nat. Bank* v. *Commissioner*, 91 F. (2d) 103 (C. C. A. 9th); *Commonwealth Commercial State Bank* v. *Lucas*, 41 F. (2d) 111 (App. D. C.); *Lebanon Nat. Bank* v. *Commissioner*, 76 F. (2d) 792 (C. C. A. 3d)). Moreover, the regulations promulgated under the Revenue Act of 1934, like those promulgated under previous statutes, provide that under certain conditions a deduction for a bad debt may be claimed with reference to bonds. Article 23 (k)–4 of Regulations 86 (Appendix, *infra*, p. 40) provides that where there is a foreclosure sale of property securing bonds of an insolvent corporation from which nothing is realized from the bondholder, the total basis is allowable as a debt. It further provides that where the bondholder ascertains that due to the financial condition of the debtor bonds he holds will not be paid at maturity, either in whole or in part, all or a part of their cost may be charged off and deducted as a bad debt. See also Article 23 (k)–1 of Regulations 86, which provides rules for deduction of bad debts generally, and which, under

proper circumstances, may be held to apply to bonds. These regulations are merely a restatement of regulations issued under earlier statutes (see Articles 191 and 194 of Regulations 77, promulgated under the Revenue Act of 1932).

Under earlier statutes similar to or identical with Section 23 (k) of the Revenue Act of 1934[8] and regulations substantially identical in all material respects with Article 23 (k)–4 of Regulations 86, it has been held that a bad-debt deduction might be claimed with respect to bonds which were ascertained to be worthless and charged off in whole or in part. *Montgomery* v. *United States*, 23 F. Supp. 130 (C. Cls.), certiorari denied, 307 U. S. 632; *Pacific Nat. Bank* v. *Commissioner, supra; Lebanon Nat. Bank* v. *Commissioner, supra; Huntting* v. *Commissioner*, 32 B. T. A. 495. See also *Santa Monica Mountain Park Co.* v. *United States*, 99 F. (2d) 450 (C. C. A. 9th);[9] *Securities Allied Corp.* v. *Commissioner*, 95 F. (2d) 384 (C. C. A. 2d), certiorari denied, 305 U. S. 617. It should be noted, however, that it was only under very unusual circumstances that a deduction was allowed with

[8] Section 23 (k) (Appendix, *infra*, p. 38) is identical with Section 23 (j) of the Revenue Act of 1932, but both differ from Section 23 (j) of the Revenue Act of 1928 which provided that when satisfied that a debt is recoverable only in part, the Commissioner might allow such debt to be charged off in part.

[9] A writ of certiorari was granted in this case (306 U. S. 624), but was dismissed by stipulation of counsel (306 U. S. 666).

respect to bonds claimed to be worthless in part. That was attributable in part to the discretion given to the Commissioner under the bad-debt provisions with respect to the allowance of deduction for debts claimed to be worthless in part (see Section 23 (j) of the Revenue Acts of 1928 and 1932; *United States* v. *Beckman*, 104 F. (2d) 260 (C. C. A. 3d), certiorari denied, *sub nom. Doty* v. *United States*, 308 U. S. 593) and in part to the fact that the regulations have always prohibited the allowance of a deduction on account of a fluctuation in the value of bonds or similar securities. *Securities Allied Corp.* v. *Commissioner, supra.* A special rule applied to banks which were required by state or federal authorities to charge off debts in part. See Article 191 of Treasury Regulations 77; *Citizens' Nat. Bank* v. *Commissioner*, 74 F. (2d) 604 (C. C. A. 4th), and it will be found that many of the cases in which deductions were allowed with respect to bonds claimed to be worthless in part involved banks.

In the case where the debt has been compromised because the debtor could not pay, the amount which could not be collected has been allowed as a bad debt. *Deeds* v. *Commissioner*, 47 F. (2d) 695 (C. C. A. 6th); *Commissioner* v. *National Bank of Commerce of San Antonio, Texas*, decided June 27, 1940 (C. C. A. 5th), not yet officially reported but may be found in 1940 C. C. H., Vol 4, ¶ 9550. See also *Commissioner* v. *Wilson*, 90 F. (2d) 788 (C. C. A. 7th); *Johnson, Drake & Piper, Inc.* v. *Helver-*

ing, 69 F. (2d) 151 (C. C. A. 8th), certiorari denied, 292 U. S. 650. In *Hale* v. *Helvering, supra,* where the debtor could pay, it was held that such a transaction did not constitute a capital loss but the court implied that it was not necessarily a bad debt. See also *Pacific Novelty Co.* v. *Commissioner,* 5 B. T. A. 1017.

But if it be conceded that the difference between the face value of the bonds and the amount received upon their surrender by the taxpayer might otherwise be deductible as a bad debt under Section 23 (k), the situation is changed by Section 117 (f). The latter provision deals specifically with the retirement of bonds, and under a well-established rule of construction a specific provision prevails over a general provision which might otherwise apply (*Missouri* v. *Ross,* 299 U. S. 72; *Hellmich* v. *Hellman,* 276 U. S. 233; *Ginsberg & Sons* v. *Popkin,* 285 U. S. 204; *United States* v. *Chase,* 135 U. S. 255). Therefore, Section 117 (f) controls if there was a retirement of the bonds, even though Section 23 (k) might otherwise be applicable. And the regulations interpreting Section 23 (k) cannot bring within the operation of the general provisions of that section the specific transactions which are governed by Section 117 (f).

Moreover, Section 117 (f) is a provision of limited application and Section 23 (k) and the regulations relating to bad debts still govern certain types of losses with respect to bonds. Section

117 (f) is a specific provision designed to meet one type of loss arising from investments in bonds, debentures, and other evidences of indebtedness issued by corporations and governments, namely, as loss on their retirement. It does not apply to similar obligations of individuals. In *Thomas* v. *Perkins*, 108 F. (2d) 87 (C. C. A. 5th), the court held that it did not apply to certificates of indebtedness issued by a creditor's committee, which took over the assets of a corporation, a partnership, and certain individuals. The same court recently has held in *Commissioner* v. *National Bank of Commerce of San Antonio, Texas, supra*, that the bad debt provisions of the Revenue Act of 1934, rather than the capital loss provisions, were applicable to a situation where the taxpayer held notes of an estate and accepted in settlement property which was worth less than the face value of the notes.[10]

But Section 117 (f) applies where any amounts are received in retirement of corporate or government obligations [11] which are capital assets. There are thus brought within the ambit of the capital

[10] Section 117 (f) also does not apply to all investments in corporate or governmental bonds or other evidences of indebtedness. It does not, for example, apply to obligations which are not capital assets as defined in Section 117 (b).

[11] See I. T. 3121, 1937–2 Cum. Bull. 138. This is one of the few Bureau rulings with reference to Section 117 (f). See also I. T. 2986, XV–1 Cum. Bull. 136 (1936). There are no regulations construing the provision.

loss provisions transactions which under previous statutes had been treated as giving rise to a deduction for a bad debt. There is nothing in Section 117 (f) itself or in its legislative history that supports the taxpayer's view that it was intended to apply only to transactions which had hitherto been held to give rise to a loss rather than a bad debt, as in the *Watson* case, *supra,* where bonds purchased at a premium were retired at a loss. It is true that Section 23 (k) (Appendix, *infra,* p. 38) was the same as Section 23 (j) of the Revenue Act of 1932. But Section 23 (e) of the Revenue Act of 1934, the general provision regarding losses, is also the same as Section 23 (e) of the Revenue Act of 1932. There is consequently no basis for the assumption that Congress meant to exclude certain losses from Section 23 (e) and to bring them under Section 117 but that it meant to have Section 23 (k) apply to all cases to which it formerly applied. Section 117 (f), moreover, was not enacted with specific reference to losses but applies to gains as well.

Inasmuch as the bonds here involved were retired and amounts were received upon their retirement, those amounts are to be treated as having been received in exchange therefor under Section 117 (f) and the difference between such amounts and the basis is a capital loss, subject to limitations of Section 117 (d), though but for those provisions the difference might be deductible as a bad debt.

CONCLUSION

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted.

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OCTOBER 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

(k) *Bad debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * *

(U. S. C., Title 26, Sec. 23.)

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of capital assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on capital losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be sub-

ject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

(f) *Retirement of bonds, etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. (U. S. C., Title 26, Sec. 101.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (k)–4. *Worthless bonds and similar obligations.*—Bonds, if ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations can not deduct from gross income any amount merely on account of market fluctuation. If a taxpayer ascertains, however, that due, for instance, to the financial condition of the debtor, or conditions other than market fluctuation, he will recover upon maturity none or only a part

of the debt evidenced by the bonds or other similar obligations and so demonstrates to the satisfaction of the Commissioner, he may deduct in computing net income the uncollectible part of the debt evidenced by the bonds or other similar obligations.

* * * * * *

ART. 117–4. *Application of section 117 generally.*—Section 117 applies only to gains and losses upon the sale or exchange of capital assets and, therefore, has no application to loss of useful value upon the permanent abandonment of the use of property (see article 23 (e)–3), or loss sustained as the result of corporate stock or debts becoming worthless.

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No. [redacted] 58

In the Supreme Court of the United States

October Term, 1939

[redacted]

vs.

[redacted]

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF [redacted]

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225392—40

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

S. C. THOMSON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the decision of the United States Circuit Court of Appeals for the Second Circuit entered in the above-entitled cause on January 25, 1940.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 10–15) is reported at 40 B. T. A. 60. The opinion of the Circuit Court of Appeals (R. 72) is reported in 108 F. (2d) 642.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 25, 1940 (R. 74). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer held certain debentures of a corporation which went into receivership. Pursuant to a court order approving a plan of reorganization of the debtor the taxpayer surrendered his debentures and received a small part of their face value in full payment and settlement. The question is:

Whether such discharge of the debentures held by the taxpayer constituted a "retirement" thereof within the meaning of Section 117 (f) of the Revenue Act of 1934 so that the difference between their cost and the amount realized upon their discharge constituted a capital loss subject to the limitations of Section 117 (d) of the Act.

STATUTE INVOLVED

The pertinent provisions of the statute involved are printed in the Appendix, *infra*, pp. 9–11.

STATEMENT

The facts were stipulated (R. 23–68), and are summarized in the opinion of the Board of Tax Appeals (R. 10–15).

In May 1927 the taxpayer purchased debentures of New York United Hotels, Inc., maturing Feb-

ruary 1, 1947, having a total face value of $25,000, for which he paid $24,750. The obligations were subject to redemption at a premium at any time after 30 days notice. (R. 10, 23–24.)

In 1931 the debtor corporation encountered financial difficulties and the debenture holders consented to a plan of readjustment whereby, on certain conditions, they waived the payment of a portion of the interest payable on the debentures. (R. 10–11, 24, 28–29.)[1]

On December 15, 1933, ancillary receivers were appointed by the United States District Court for the Southern District of New York, at which time a plan to reorganize the debtor corporation was submitted to the court. The plan contemplated a sale of the assets of the corporation to a new corporation and permitted the debenture holders to purchase for cash, at par plus accrued interest, debentures to be issued by the new corporation having a face value equal to 1/100 of the face value of the old debentures. (R. 11, 24, 34–35, 40.) Upon purchase of the new debentures and surrender of the old debentures, the debenture holder was also entitled to receive with each $10 face value of new debentures, 5 shares of preferred stock of the new company and a voting trust certificate for 5 shares of common stock of the new company.[2] (R.

[1] The corporation had debentures of $5,113,500 outstanding. (R. 27.) Holders of debentures in the amount of $4,551,500 consented to this plan of readjustment. (R. 30.)

[2] Debenture holders who did not purchase the new debentures were to receive a voting trust certificate for 2½ shares of common stock of the new company. (R. 40.)

11, 24, 34–35, 40.) A supplemental plan (R. 44–46) was submitted to the court in February, 1934, making minor changes in the original plan (R. 11, 24).

On March 8, 1934, the court entered an order (R. 47–55) approving the plan, though there was no provision thereunder for debenture holders who did not participate in the plan of reorganization. (R. 11, 24, 40, 42.)

On May 22, 1934, the court entered its final order (R. 58–62) in the reorganization proceedings under which the receivers were directed, *inter alia,* to pay to debenture holders who would surrender their debentures with all coupons attached before a fixed time, $5 for each $1,000 face amount. (R. 11, 24–25.)[3]

Pursuant to the order of the court the taxpayer received a written notice which stated that the debtor corporation's assets had been sold and that he was entitled to receive $5 for each $1,000 face amount of his debentures upon surrendering them, with all interest coupons attached, on or before

[3] This statement is taken from the Board's findings and the stipulation. The court order, however, discloses that the receivers were directed to pay over certain funds to the debtor's landlord on the condition that it agree to pay over to the new company amounts sufficient to pay the debenture holders. (R. 61–62, 66.) The receivers were then discharged and the new corporation accepted the surrender of the debentures and paid the debenture holders. (R. 66–67.) This new corporation was the Roosevelt Hotel, Inc. (R. 49–50, 66–67.)

August 20, 1934. (R. 11, 25, 66–67.) This payment was stated to be "in full payment and settlement of said Debentures." (R. 11, 25, 67.) The taxpayer surrendered his debentures (for which he had paid $24,750) on June 22, 1934, and received $125 in cash for them. (R. 11, 25.)

The taxpayer attempted to deduct the difference between the cost of his debentures ($24,750) and the amount he received from the trustee in final settlement ($125) in his 1934 return as a bad debt. The Commissioner of Internal Revenue ruled that the transaction was governed by Section 117 (f) of the Revenue Act of 1934, and treated the amount in controversy as a capital loss subject to the limitations imposed by Section 117 (d) of the Act. (R. 6–7, 10, 23.) The Board of Tax Appeals sustained that determination (R. 10–16), but the Circuit Court of Appeals reversed (R. 72–73).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the transaction shown by the record did not constitute a retirement within the meaning of Section 117 (f) of the Revenue Act of 1934 of the debenture bonds held by the taxpayer.

2. In failing and refusing to hold that the loss resulting from the surrender and discharge of the debenture bonds held by the taxpayer constituted a capital loss subject to the limitations imposed by Section 117 (d) of the Revenue Act of 1934.

3. In holding that the loss resulting from the surrender and discharge of the debenture bonds held by the taxpayer constituted a bad debt deductible in full from the gross income.

4. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The provisions in Section 117 (f) were first enacted in the Revenue Act of 1934; they are provisions of considerable importance and are frequently applied. The doubt which the decision below casts upon their meaning threatens to disrupt the orderly administrative application of the statute to concrete situations, and it is therefore a matter of general importance to obtain an authoritative decision as to the scope of Section 117 (f).

The confusion produced by the decision below is accentuated by the fact that it is in substantial conflict with *McClain* v. *Commissioner* (C. C. A. 5th), decided March 23, 1940 (not yet officially reported but published in Vol. 4, Prentice Hall, 1940, par. 62,518), affirming an unreported memorandum opinion of the Board of Tax Appeals which, in turn, was based upon its decision in this very case. In the *McClain* case the taxpayer, in 1918, acquired Water Improvement District bonds of Cameron County, Texas, which had a then value and cost basis to him of $15,000. The District was unable to pay the principal and interest on these bonds in

1935. It unsuccessfully sought municipal bankruptcy, then applied to the Reconstruction Finance Corporation for a loan. The loan was granted in an amount sufficient to pay $0.499 per dollar on its bonds upon condition that a sufficient amount of the bonds be deposited and committed to the plan of refinancing required by the Reconstruction Finance Corporation. The taxpayer, with other bondholders, deposited his Water Improvement District bonds in accordance with that condition, the refinancing plan was carried out, and he received $7,476.75 in 1935 in full settlement and cancellation of his bonds. He attempted to deduct the difference between that amount and his cost basis as a bad debt in his 1935 return. The Commissioner of Internal Revenue ruled that the taxpayer's Water Improvement District bonds had been retired within the meaning of Section 117 (f) of the Revenue Act of 1934, *infra,* and that the loss deduction was subject to the limitations of Section 117 (d). The Board of Tax Appeals and the Circuit Court of Appeals sustained that determination.

The question in the *McClain* case, as well as in the present case, was whether payment and discharge of the obligation in question constituted "retirement" within the meaning of Section 117 (f). Although it is possible to spell out differentiating features in the facts of the two cases, we believe that they are broadly in conflict with each other, and in any event are productive of such un-

certainty with respect to the correct interpretation of Section 117 (f) as to call for further review by this Court.

2. A petition for a writ of certiorari has been filed in *Helvering* v. *Hammel,* No. 895, present Term, involving a cognate question under Section 117 (d). Although the issues are not identical, they are sufficiently similar to justify considering them together. Accordingly, if certiorari be granted in the *Hammel* case, it should likewise be granted here in order that the Court may have a more complete presentation of the general problem.

CONCLUSION

Wherefore, it is respectfully submitted that this petition should be granted.

FRANCIS BIDDLE,
Solicitor General.

APRIL 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

(k) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * *

[U. S. C., Title 26, Sec. 23.]

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be

included in determining the applicability of such limitation to other losses.

* * * * *

(f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. [U. S. C., Title 26, Sec. 101.]

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 58

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

S. C. THOMSON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 6–9) is reported in 40 B. T. A. 60. The opinion of the Circuit Court of Appeals (R. 40–41) is reported in 108 F. (2d) 642.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 25, 1940 (R. 41–42). The petition for a writ of certiorari was filed April 25, 1940, and was granted May 20, 1940 (R. 42). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer owned corporate debentures. Pursuant to a court order approving a plan of reorganization of the corporation, the taxpayer surrendered his debentures and received a small part of their face value in full payment. The question presented is whether the deductibility of the resulting loss is subject to the limitations upon capital losses contained in Section 117 (d) of the Revenue Act of 1934. The answer to this question, in turn, depends upon whether the discharge of the debentures constituted a "retirement" thereof within the meaning of Section 117 (f) of the Revenue Act of 1934.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations involved will be found in the Appendix, *infra*, pp. 34–37.

STATEMENT

The facts as stipulated (R. 13–38) and as found by the Board of Tax Appeals (R. 6–9) are substantially as follows:

In May 1927 the taxpayer, a resident of New York, purchased twenty-year 6% sinking-fund gold debentures of the New York United Hotels, Incorporated, maturing February 1, 1947, having a total face value of $25,000 for which he paid $24,750. The debentures were subject to redemption at a premium by the debtor at any time after notice of thirty days (R. 6, 13).

In 1931 the debtor corporation encountered financial difficulties and the debenture holders consented to a plan of readjustment whereby, on certain conditions, they consented to a reduction in and postponement of payment of interest (R. 6, 13, 16–17).[1]

On December 15, 1933, ancillary receivers were appointed by the United States District Court for the Southern District of New York, and a plan to reorganize the debtor corporation was submitted to the court[2] (R. 6, 13, 15–24).

---

[1] The corporation had debentures of $5,113,500 outstanding (R. 15). Holders of debentures in the amount of $4,551,500 agreed to the plan (R. 17).

[2] The plan contemplated a sale of the assets of the corporation to a new corporation and permitted the debenture holders to purchase for cash at par plus accrued interest debentures to be issued by the new corporation having a face value equal to 1/100 of the face value of the old debentures (R. 23). Upon purchase of the new debentures and surrender of the old the debenture holder was also entitled to receive with each $10 face value of new debentures five shares of preferred stock of the new company and a voting trust certificate for five shares of common stock of the new company (R. 23). A debenture holder who did not purchase any new debentures was entitled to receive a voting trust certificate for two and one-half shares of common stock for each $1,000 debenture surrendered (R. 23). The plan was subsequently modified in some respects when the new company, Roosevelt Hotel, Incorporated, changed the offer concerning the purchase of the assets of the debtor (R. 25–26, 29). On March 8, 1934, the court entered an order (R. 27–32), approving the plan of reorganization, although there was no provision for debenture holders who did not participate in the plan of reorganization (R. 6, 14, 23).

On May 22, 1934, the court entered its final order in the reorganization proceedings (R. 33–36).[3] The court order discloses that the receivers were directed to pay over certain funds to the debtor's landlord on the condition that the latter agree to turn over to the new corporation amounts sufficient to pay the debenture holders $5 for each $1,000 face amount of the debentures upon surrender of the debentures with all coupons attached (R. 35–36). The receivers were then discharged and the new corporation accepted the surrender of the debentures and paid the debenture holders (R. 37–38).[4] Pursuant to the order of the court the taxpayer received a written notice which stated that the debtor corporation's assets had been sold, and that he was entitled to receive $5 for each $1,000 face amount of his debentures upon surrendering them to the Roosevelt Hotel, Incorporated, with all interest coupons attached, on or before August 20, 1934 (R. 6, 14, 37–38). It was stated that the payment so made would be in full payment and settlement of said debentures (R. 6, 14, 38). The taxpayer surrendered his debentures (for which he had paid

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[3] The decision of the District Court approving the plan was upheld by the Circuit Court of Appeals for the Second Circuit in *Rockwell* v. *New York United Hotels*, 79 F. (2d) 81, certiorari denied *sub nom.*, *Donahue* v. *Rockwell*, 296 U. S. 650.

[4] The Board's findings (R. 6) and the stipulation (R. 14) indicate that the receivers were directed to receive the debentures and pay the debenture holders, but the order does not thus provide (R. 35–36).

$24,750) on June 22, 1934, and received $125 in cash for them (R. 6, 14, 38).

In his 1934 return the taxpayer attempted to deduct the difference between the cost of his debentures ($24,750) and the amount he received in final settlement ($125) as a bad debt. The Commissioner of Internal Revenue, in determining the deficiency, ruled that the transaction was governed by Section 117 (f) of the Revenue Act of 1934 and treated the amount in controversy as a capital loss subject to the limitations imposed by Section 117 (d) of the Act (R. 4).

The Board of Tax Appeals sustained the Commissioner's determination. The Circuit Court of Appeals reversed the Board, holding that there was no retirement of the debentures within the meaning of Section 117 (f), and that the transaction did not give rise to a capital loss but was governed by the bad debt provision of the statute. It remanded the case to the Board for proper findings under the latter provision.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the transaction shown by the record did not constitute a retirement within the meaning of Section 117 (f) of the Revenue Act of 1934 of the debenture bonds held by the taxpayer.

2. In failing and refusing to hold that the loss resulting from the surrender and discharge of the debenture bonds held by the taxpayer constituted

a capital loss subject to the limitations imposed by Section 117 (d) of the Revenue Act of 1934.

3. In holding that the loss resulting from the surrender and discharge of the debenture bonds held by the taxpayer constituted a bad debt deductible in full from gross income.

4. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The question as to whether the taxpayer sustained a capital loss which is deductible only to the extent provided in Section 117 (d) of the Revenue Act of 1934 depends upon whether the surrender of his debentures for cash in the course of the receivership and reorganization of the debtor corporation constituted a sale or exchange of capital assets within the meaning of Section 117 (d). The Government concedes that the transaction would not constitute a sale or exchange independently of Section 117 (f) since this Court has held that under statutes which contained no provision analogous to Section 117 (f), the payment of and discharge of a bond in accordance with the terms of the contract was not a sale or exchange and did not result in a capital gain or loss. Presumably the payment of a lesser sum than the amount due under the contract in discharge of the obligation would also fail to qualify as a sale or exchange. But Section 117 (f) changed the existing law.

That subsection provides in substance that for the purpose of the income tax title, amounts re-

ceived by the holder upon the "retirement" of corporate bonds, debentures, and other evidences of indebtedness shall be considered as amounts received in exchange therefor. If, therefore, the sum of $125 which the taxpayer received upon the surrender of his debentures was received upon their "retirement," the difference is to be treated as a capital loss.

The word "retirement" must be taken to have been used in its ordinary sense in Section 117 (f). The verb "retire" has been defined as meaning "to withdraw from circulation, to take up and pay." In the instant case, the debentures were withdrawn from circulation and taken up and paid when the taxpayer and other debenture holders were required to surrender their debentures and accept cash payments in full satisfaction of their debt so that the reorganization could proceed. Hence, there was a retirement within the literal meaning of Section 117 (f).

The term "retirement" is a broader term than redemption and the statute is not limited to cases where the debtor redeems the bonds in accordance with the terms of the contract. The legislative history of the provision shows that Congress chose the broader term deliberately and in an analogous case now before this Court another Circuit Court of Appeals applied it in a situation where no redemption occurred.

There is no foundation for the assumption made by the taxpayer and the court below that the statute

applies only where there is a voluntary discharge of the obligation by the debtor but not where the discharge is involuntary. The purpose of Congress in enacting Section 117 would not be given effect if such a distinction were made. The legislative history indicates that Congress intended to stabilize the revenue by preventing capital losses from being applied against ordinary income. It could achieve that purpose only by making Section 117 (f) apply where the conversion of corporate obligations into cash resulted from forced liquidations as well as from voluntary action on the part of the debtor. Moreover, from the standpoint of the bondholder or debenture holder, who is the taxpayer involved, the two transactions have the same aspect. In each there is a loss of capital investment, and there is no occasion to differentiate between the two situations.

The fact that Section 23 (k) (2) of the Revenue Act of 1938 changed the existing law so as to provide that losses sustained upon securities becoming worthless should also be treated as exchanges does not indicate that such a loss as the one here involved was not already embraced within Section 117 (f). Section 23 (k) (2) refers only to cases where the bonds retained by the taxpayer have become totally worthless.

The application of Section 117 (f) does not depend upon whether the amount received upon the retirement of securities is large or small. If it

applies to any case where bonds or debentures are surrendered for cash in a receivership proceeding it applies to all since the statute provides that "amounts received by the holder" upon the retirement of corporate bonds or other evidences of indebtedness shall be treated as having been received in exchange therefor. But, if an exception should be made in a case where the payment is purely nominal, this is not such a case.

Inasmuch as there was a "retirement," the transaction is to be treated as an exchange of capital assets giving rise to a capital loss rather than as a bad debt and the deduction is subject to the limitations of Section 117 (d).

ARGUMENT

THE TAXPAYER'S SURRENDER OF HIS DEBENTURES FOR CASH CONSTITUTED A RETIREMENT OF THE DEBENTURES WITHIN THE MEANING OF SECTION 117 (f) OF THE REVENUE ACT OF 1934 AND THE LOSS THEREBY SUSTAINED WAS A CAPITAL LOSS

1. *Introductory.*—In 1927 the taxpayer purchased debentures of the New York United Hotels, Incorporated, for $24,750. (R. 6). In 1934, pursuant to an order issued by the United States District Court for the Southern District of New York in the course of a receivership of the debtor corporation and a plan for its reorganization, the taxpayer surrendered his debentures to the new corporation acquiring the debtor's assets and received $5 for each $1,000 debenture surrendered

for cancellation, or a total of $125 (R. 6).[5] If, as the Government contends, and as the Board of Tax Appeals held, the difference of $24,625 between the cost of the debentures and the amount realized therefrom is a capital loss, the taxpayer is not entitled to deduct it for the reason that capital losses arising from other sources have already been allowed to the extent of the taxpayer's capital gains plus $2,000 (R. 4, 6–7), and no additional deduction for capital losses is allowable under Section 117 (d) (Appendix, *infra,* p. 35). If the difference is not a capital loss, it may be deducted as a bad debt under Section 23 (k) of the Revenue Act of 1934 (Appendix, *infra,* p. 34) if the requirements of that section are met.

That the debentures in controversy were capital assets is not disputed. The only question presented is whether there was a sale or exchange of such capital assets within Section 117 (d) which is expanded by Section 117 (f) to include "retirement" of corporate and Governmental obligations. If the transaction under review constituted such a "retirement," then the resulting capital loss is subject to the foregoing statutory restrictions. The same question is also before the Court in *McClain* v.

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[5] The funds for this payment were furnished by the landlord of the debtor corporation after certain funds had been transferred to it by the receivers and the receivers had been discharged (R. 35–36, 37–38). In legal effect, therefore, the payment was made from the debtor's assets, and respondent has never contended otherwise.

Comissioner, No. 55, October Term, 1940, involving somewhat different facts, and the Court is referred to our brief in that case for a more complete statement of the legislative history of these provisions.

The Government concedes that in the absence of Section 117 (f), this transaction would not be a sale or exchange within the meaning of Section 117 (d). In *Fairbanks* v. *United States,* 306 U. S. 436 which arose under the predecessor provisions of the Revenue Acts of 1926 and 1928 (c. 27, 44 Stat. 9, Sec. 208; c. 852, 45 Stat. 791, Sec. 101), this Court held that the payment of or discharge of a bond in accordance with its terms was not a sale or exchange. Presumably the payment of a lesser sum than the amount due under the contract would also fail to qualify as a sa' or exchange. Those acts did not contain any provisions comparable to Section 117 (f) of the 1934 Act, here under review, which expanded the concept of sale or exchange to include retirement. Indeed, the Court in the *Fairbanks* case recognized that the new provisions, which it had no occasion to construe in that case, represented a material addition to existing law.

The instant case, therefore, presents a new issue, and turns upon the construction of Section 117 (f), which provides as follows:

> (f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evi-

dences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

The court below held that the discharge of the taxpayer's debentures for cash in the receivership proceedings was not a retirement of the debentures within the meaning of Section 117 (f) on the ground that the word "retirement" signified some voluntary action on the debtor's part in fulfillment of his promise to pay and that in this case there was an extinguishment of the obligations rather than a retirement. The court, therefore, held inapplicable the capital loss provisions of Section 117, and determined that the case was one of a bad debt controlled by Section 23 (k) of the Revenue Act of 1934 (Appendix, *infra*, p. 34).

It is our position that in construing Section 117 (f) the court below unduly restricted the meaning of the word "retirement" and failed to give effect to the intention of Congress in enacting this provision.

2. The word "retirement" has no established legal meaning and must, therefore, be given its common and ordinary meaning. *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 560; *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 327; *Old Colony Co.* v. *Commissioner*, 301 U. S. 379, 383. The verb "retire" is defined in Webster's New International

Dictionary (1939 Ed.), p. 2128, as meaning, among other things, "To withdraw from circulation, or from the market; to take up or pay; as, to *retire* bonds; to *retire* a note." The Century Dictionary and Cyclopedia (Revised Ed.), Vol. VIII, p. 5123, defines "retire" as meaning "To recover; redeem; regain by the payment of a sum of money; * * *." The latter definition was approved as applied to a note in *Empire Security Co.* v. *Berry,* 211 Ill. App. 278, and was accepted by the Circuit Court of Appeals for the Fifth Circuit in *McClain* v. *Commissioner,* 110 F. (2d) 878, now before this Court on writ of certiorari, No. 55, October Term, 1940, in construing Section 117 (f).

It is our position that the term "retirement" as thus defined covers all transactions by which bonds are surrendered for cash and discharged either by the debtor or one standing in the position of the debtor.

As employed in its ordinary sense, the word "retirement" is properly used to describe the transaction by which, in receivership or bankruptcy proceedings, the bondholders or debenture holders of a debtor corporation are required to surrender their bonds or debentures and accept cash payments in full satisfaction of their debt so that a reorganization may proceed. In such cases, when the securities are taken up and paid, there is actually a withdrawal from circulation in order to make possible the issuance of new securities by the

reorganized corporation. Accordingly, when Congress used the word "retirement" in Section 117 (f), we believe that it indicated its intention to have the statute apply to the type of transaction that is here involved.

If the word "redemption" rather than the word "retirement" had been used there might have been some basis for the court's conclusion that that section does not apply to the transaction in this case. A redemption has been defined as meaning "the payment of an obligation according to its terms" (*United States* v. *Fairbanks*, 95 F. (2d) 794 (C. C. A. 9th), affirmed, 306 U. S. 436; *Watson* v. *Commissioner*, 27 B. T. A. 463; *Braun, Trustee*, v. *Commissioner*, 29 B. T. A. 1161), and in this case the debentures were not taken up and paid in accordance with the original contract. But the statute employs the term "retirement," not the term "redemption," and while a retirement undoubtedly includes a redemption,[6] we submit that the former is the more inclusive term and that the court erred in holding that it did not apply to the instant case where securities were surrendered for cash in full discharge.

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[6] That the two words are not the same is suggested by the fact that both are used under the reorganization provisions of the Bankruptcy Act in such manner as to indicate that Congress believed them to have different contents. See Act of June 22, 1938, c. 575, 52 Stat. 840, 895–897, amending Section 216 (12) (b) of the Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended.

3. Although the reports of the Senate Committee on Finance and the Committee on Ways and Means of the House of Representatives do not reveal precisely what meaning Congress attributed to the word "retirement" in Section 117 (f) of the Revenue Act of 1934 (see H. Rep. No. 704, 73d Cong., 2d Sess., pp. 9–10; S. Rep. No. 558, 73d Cong., 2d Sess., pp. 11–13), the legislative history does disclose that the choice of the word "retirement" was deliberate. The Committee on Federal Taxation of the American Bar Association had recommended to the Committee on Ways and Means of the House that the existing law be amended to make it clear that the definition of capital gains and losses include gains or losses arising from redemption of capital assets. House Hearings before the Committee on Ways and Means on Revenue Revision, 1934, 73d Cong., 2d Sess., pp. 190–191.[7] The substitution

[7] A suggestion that the definition of capital gain and capital loss be changed so as to make it clear that it included gain or loss from "the redemption or retirement of corporate securities" had been made by Arthur A. Ballantyne, Chairman of the Committee on Taxation of the Association of the Bar of the City of New York, during the hearings before the Committee on Finance, United States Senate, on the Revenue Bill of 1928 (Hearings before the Committee on Finance, United States Senate, on H. R. 1, 70th Cong., 1st Sess., pp. 295, 297), but was not adopted. The Board subsequently held in *Watson* v. *Commissioner*, 27 B. T. A. 463 (decided in December 1932) and *Braun, Trustee* v. *Commissioner*, 29 B. T. A. 1161 (decided in February 1934), that payments of the amounts specified in a bond either at maturity or pursuant to an authorized call

of the word "retirement" for "redemption" in the statute as finally enacted suggests, therefore, that Congress deliberately chose a more comprehensive word.

It should also be remembered that when Congress enacted the Revenue Act of 1934 the Board of Tax Appeals had decided *Watson* v. *Commissioner*, 27 B. T. A. 463. That case involved a taxpayer who had purchased Liberty bonds at a premium and had realized a loss when the bonds were paid at maturity. The Board held that the loss was not a capital loss for the reason that payment of the amounts specified in bonds either at maturity or pursuant to an authorized call prior to maturity was not a sale or exchange within the meaning of the statute there involved but merely constituted a satisfaction of the obligation by payment. If Congress had intended simply to overcome the effect of the decision in the *Watson* case, it could have done so by using the word "redemption" in the statute. It would then have been clear that only the discharge of an obligation according to its terms was to be treated as an exchange of capital assets. But when Congress chose the broader term "retirement" it must have intended to cover all cases in which an obligation is discharged by payment.

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prior to maturity did not constitute a sale or exchange. It thereby reversed an earlier decision, *Werner* v. *Commissioner*, 15 B. T. A. 482. It was undoubtedly those decisions which led to the enactment of Section 117 (f) of the Revenue Act of 1934.

Moreover, there would be no sound reason for drawing such a distinction. In each situation there is actually a loss of capital investment, and it should make no difference how the discharge of the obligations occurred. It seems hardly likely that Congress could have intended two loss-producing transactions, essentially similar from the taxpayer's point of view, to be treated differently for tax purposes.

That was apparently the view taken by the Circuit Court of Appeals for the Fifth Circuit in *McClain* v. *Commissioner*, 110 F. (2d) 878, now pending before this Court on certiorari, No. 55, October Term, 1940. In that case, the court held that Section 117 (f) did apply to a situation where bonds were retired by the debtor corporation otherwise than in accordance with the terms of the agreement. There, a water improvement district, a political subdivision of the State of Texas, defaulted on the payment of both principal and interest of its bonds. After having sought municipal bankruptcy in vain, it applied to the Reconstruction Finance Corporation for a loan. That agency agreed to lend only enough to pay 49.9% of the principal of the bonds and as a condition of the loan required that the bondholders deposit their bonds with a committee to be cancelled upon payment of the reduced amount. The court held that the deposit of the bonds for surrender and their surrender for cancellation on payment by the district of the

agreed sum was a retirement of the bonds within the meaning of Section 117(f). *Corbin* v. *Commissioner*, 39 B. T. A. 1163, is to the same effect.

It is clear that the *McClain* case and the case at bar both involve a situation where the discharge of the obligations was not made in accordance with the terms of the original contract. In a strict sense, there was no redemption of the bonds in either case, and we believe that there are no differences of fact that are material.

It is true that in the *McClain* case the municipal corporation was unable to declare itself a bankrupt and, therefore, resorted to a Reconstruction Finance Corporation loan which enabled it to discharge its bonds and resume its operations, whereas in the instant case the debtor corporation went into a receivership and the bonds were discharged by payments from the debtor's assets. On the basis of the difference in facts the taxpayer apparently concedes (Br. in Op., p. 4) that there was a retirement in the *McClain* case because there was a voluntary discharge of the debt by the debtor but argues that such is not the situation here.

It may be argued, however, that in the *McClain* case, as in the instant case, the transaction was not voluntary in any real sense. The debtor, a municipal corporation, would have declared itself a bankrupt had it been legally possible for it to do so. When that was found impossible, the district resorted to other means of ridding itself of its bonded indebtedness.

4. But even if the transaction in the *McClain* case were considered a voluntary transaction, and the transaction here an involuntary one, we submit that there is no foundation for the assumption made by the taxpayer and by the court below that the statute draws a distinction between a case where there is a voluntary discharge of the obligation by the debtor and one where the discharge is involuntary.

Under earlier statutes this Court held, in the *Fairbanks* case, *supra,* that a redemption of bonds prior to maturity did not constitute an exchange of capital assets because it represented a discharge of the debt and not because the transaction was involuntary from the standpoint of the debtor. Clearly there would have been no basis for the latter holding, for a redemption is voluntary from the debtor's standpoint. The more reasonable assumption, therefore, is that in enacting Section 117 (f) Congress sought to extend the operation of the capital gain-and-loss provisions to all discharges of securities effected by cash payments, whether voluntarily or involuntarily made. All such transactions represent a conversion of the assets into cash and thus bear a close resemblance to conversions effected by a sale. There would be no reason for treating voluntary and involuntary transactions differently for tax purposes.

Moreover, the purpose of Congress in enacting Section 117 would not be given effect if such a

distinction were made. The Revenue Act of 1934 made fundamental changes in the treatment of capital gains and losses. Prior to 1934 different rates of tax applied to capital net gains and capital net losses of individuals (see Section 101 of the Revenue Act of 1932, c. 209, 47 Stat. 169), and there was no segregation of the capital gains and losses of corporations. The effect of Section 117 of the 1934 Act is that both for individuals and corporations capital gains and losses are treated as other income or deductions in computing taxable net income, but the amount of the gain or loss to be recognized and taken into account for that purpose is subject to certain limitations.

The first limitation, imposed by Section 117 (a), applies only to individuals. Capital gain or loss is to be recognized only in certain percentages dependent upon the length of time that the asset has been held, the highest percentage applying to the asset held for the shortest time. The second limitation imposed by Section 117 (d) and applicable to individuals and corporations alike limits the deduction of capital losses to an amount not in excess of the capital gains plus $2,000. One of the purposes of both provisions, and particularly of Section 117 (d), was to achieve more stability in the revenues by preventing ordinary taxable income from being diminished by capital losses. See H. Rep. No. 704, 73d Cong., 2d Sess., pp. 9–10, 30–32, and statement on the Senate Floor by Chair-

man Harrison of the Senate Finance Committee (Cong. Record, Vol. 78, Part 6, p. 5846).

If Congress meant to stabilize the revenue, it must have intended Section 117 (f) to apply where the conversion of obligations into cash resulted from forced liquidations as well as from voluntary action on the part of the debtor; for 1934 was a year of depression and much forced liquidation of capital was taking place.

There are three types of situations in which a taxpayer may realize a loss upon corporate or government obligations, namely, (1) a disposition of the securities by a sale or exchange, which involves a transaction with a third person, (2) a surrender of the securities to the debtor or someone standing in the position of the debtor for cash, and (3) the securities becoming worthless, which does not involve any transaction with anyone. The first two of these situations, but not the third, could also give rise to a gain.

Under the statutes prior to 1934, only the first situation, namely, a disposition of the securities by a sale or exchange was covered by the capital gain and loss provisions. In a transaction which resulted in the surrender of the securities and the payment of cash, but involving the creditor and debtor only, there was not a sale or exchange.

It is obvious that from the point of view of taxation, there had never been any reason, apart from the controlling language of the statute, for treating

differently the various types of losses which a taxpayer sustains on investments in corporate and government bonds or similar evidences of indebtedness. The practical consequences to the bondholder are the same whether his loss is sustained (1) by selling the bonds to a third person, (2) by surrendering them to his debtor, or someone standing in the debtor's position, for cash, whether in pursuance of the original contract or otherwise, or (3) by having them become worthless on his hands. The second situation, however, more closely resembles a sale than does the third, since in both cash is received and the securities are disposed of.

It is our position that when Congress enacted Section 117 (f) of the Revenue Act of 1934, it intended to cover all transactions coming within the second class. It is logical to assume that this was its intention because of the resemblance which these transactions bore to sale, because of the language of the statute itself, which requires that "amounts received upon retirement" of such obligations shall be treated as having been received in exchange therefor, and because, as we subsequently point out, in enacting the Revenue Act of 1938, Congress dealt separately with the third class of cases, namely, those involving a situation where the securities had become totally worthless.

We submit that there is no basis for the assumption that Congress intended that amounts received

in discharge of obligations by the debtor should be treated as an exchange, but that amounts received in discharge of an obligation effected in some other manner should not be so treated.[8] Neither would constitute an exchange independently of Section 117 (f) and if Congress meant to treat one as an exchange it no doubt meant to treat both as exchanges. From the standpoint of the bondholder or debenture holder, who is the taxpayer involved, the two transactions have the same aspect. Moreover, both transactions resemble transactions resulting in a conversion of stocks of a corporation into cash upon a liquidation, the loss on which was already treated as a capital loss for tax purposes.[9] Congress undoubtedly intended that the investor in stocks and the investor in corporate bonds and other evidences of indebtedness should be treated similarly for tax purposes.

The taxpayer will probably renew his contention made below that if Congress had intended to classify a loss like his as a capital loss rather than as a

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[8] In *Commissioner* v. *Hammel*, No. 49, October Term, 1940, and *Electro-Chemical Engraving Co.* v. *Commissioner*, No. 62, October Term, 1940, the taxpayers are contending that Section 117 applies only to sales which are voluntary sales by the taxpayers and does not apply to foreclosure sales of the taxpayer's property. It is our position in those cases as here that the application of the statute does not depend on the voluntary or involuntary character of the transaction.

[9] See *White* v. *United States*, 305 U. S. 281; *Helvering* v. *Weaver Co.*, 305 U. S. 293.

bad debt, it would have found no difficulty in saying so, and that it did thus classify such losses in Section 23 (k) of the Revenue Act of 1938, c. 289, 52 Stat. 447.

Section 23 (k) (2) of the Revenue Act of 1938 provides that if securities (defined in Section 23 (k) (3) as including bonds, debentures, notes, certificates, or other evidences of indebtedness issued by private or governmental corporations with interest coupons or in registered form) are ascertained to be worthless and charged off within the taxable year and are capital assets, the loss resulting therefrom shall, except in the case of a bank, be considered as a loss from the sale or exchange of capital assets on the last day of the taxable year. It will be noted that this section in terms relates solely to securities which become wholly worthless and are charged off during the taxable year. It is similar to Section 23 (g) (2) and (3) relating to worthless stock and stock rights. It does not specifically apply to a situation where bonds are surrendered in consideration of a cash payment in a receivership and reorganization proceeding and the legislative history does not disclose that Congress had such a situation in mind. The Committee Reports indicate that Congress intended this provision to apply only to securities retained by the taxpayer, which were determined to be totally worthless. See H. Conference Rep. No. 2330 on the Revenue Bill of 1938, 75th Cong., 3d Sess., p. 35. See also

Report of Subcommittee of the Committee on Ways and Means on a Proposed Revision of the Revenue Laws, 75th Cong., 3d Sess., pp. 44–46.

The Treasury Department Regulations have construed this section as being applicable only to such a situation. See Article 23 (k)–4 of Regulations 101, promulgated under the Revenue Act of 1938. Section 23 (k) (2), therefore, does not refer to a situation where the bondholder surrenders his bonds for cash in a reorganization proceeding.

It would be clearly unreasonable, however, to assume that Congress intended losses sustained upon wholly worthless securities to be treated as exchanges, while at the same time according different treatment to losses upon securities discharged by cash payments in a receivership. It undoubtedly thought that the latter situation was taken care of by Section 117 (f) of the Revenue Act of 1938 which is identical with Section 117 (f) in the Revenue Act of 1934, here involved. *In other words, Section 117 (f) covered all transactions (other than actual sales or exchanges) by which bonds, debentures, or similar evidences of indebtedness were converted into cash, even though the effect of the transaction was merely to discharge the debt and there was no sale or exchange in a technical sense, and Section 23 (k) (2) covered all situations where such securities were still held by the taxpayer but had become totally worthless,* even though there was neither an exchange nor a conversion into cash.

Congress must have intended to bring both transactions within the operation of the capital gain and loss provisions, since the former, which results in the receipt of cash, more clearly resembles and more nearly has the effect of an exchange or sale, and must, therefore, have believed that the former was included under Section 117 (f). And if that is the meaning of Section 117 (f) of the Revenue Act of 1938, it is also the meaning of Section 117 (f) of the Revenue Act of 1934, for the two provisions are identical.

5. The court below apparently thought that the bad debt provisions of the Revenue Act of 1934 rather than the capital loss provisions were applicable, both because the regulations issued under the former refer to bankruptcy proceedings as establishing the worthlessness of debts and because the amount received in satisfaction of the debentures in this case was so small—only ½ of 1%.

The regulation to which the court referred is Article 23 (k)–1 of Regulations 86, promulgated under the Revenue Act of 1934, which does not relate specifically to bonds but which, in reference to bad debts generally, lays down the following rule:

> * * * Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the

> debt for the purpose of deduction. Bankrutcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases is sometimes possible before and at other times only when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year. * * *

The Government does not deny that bonds have been treated as debts within the meaning of the bad-debt provisions of the Revenue Act of 1934 and previous statutes. *Pacific Nat. Bank* v. *Commissioner,* 91 F. (2d) 103 (C. C. A. 9th); *Commonwealth Commercial State Bank* v. *Lucas,* 41 F. (2d) 111 (App. D. C.); *Lebanon Nat. Bank* v. *Commissioner,* 76 F. (2d) 792 (C. C. A. 3d). But the above regulation appears to be applicable only to unsecured and unpreferred debts. It should be noted that another regulation, Article 23 (k)–3, refers to cases where there is an uncollectible deficiency upon the sale of mortgaged or pledged property and that Article 23 (k)–4 (*Appendix, infra,* p. 36) is the only regulation dealing with bonds. That regulation refers to two situations: (1) Where there is a foreclosure sale of property

securing bonds of an insolvent corporation from which nothing is realized for the bondholders, in which case the total basis is allowable as a bad debt; and (2) where the bondholder ascertains that due to the financial condition of the debtor bonds he holds will not be paid at maturity, either in whole or in part, in which case all or a part of the cost of the bonds is deductible as a bad debt.

We submit that this regulation which is merely a restatement of regulations issued under earlier statutes (see Article 191 of Regulations 77, promulgated under the Revenue Act of 1932) presents no obstacle to a holding that the capital-loss provisions rather than the bad-debt provisions of the Revenue Act of 1934 are applicable to this case where the bonds were discharged for cash in a receivership proceeding. Article 23 (k)-4 relates to a situation where bonds retained by the taxpayer are ascertained to be worthless in whole or in part prior to maturity and do not specifically refer to a situation where corporation bonds are surrendered for cash in a receivership proceeding. At best, the regulation is ambiguous. It may relate only to bonds which do not constitute capital assets as defined in Section 117, and hence do not come under Section 117 (f). Probably it was intended to govern obligations not otherwise removed from the operation of the bad-debt provisions by such specific provisions relating to capital losses as are contained in Section 117. In any event, it fails to disclose

that the Treasury Department has treated a discharge of bonds for cash in a receivership as falling under the bad-debt provisions rather than under the capital-loss provisions of the Revenue Act of 1934. As the Board of Tax Appeals suggested in *Corbin* v. *Commissioner*, 39 B. T. A. 1163, the regulation in question throws no light on the proper construction of Section 117 (f). The latter section provides that "For the purpose of this title," amounts received on the retirement of corporate securities are to be treated as amounts received in exchange for such securities. Section 117 (f), therefore, obviously limits the application of the bad-debt provisions to situations which are not embraced within that section.

Section 117 (f) deals specifically with the retirement of bonds. And under the well-established rule of construction that a specific provision prevails over a general provision which otherwise might apply (*Missouri* v. *Ross*, 299 U. S. 72; *Ginsberg & Sons* v. *Popkin*, 285 U. S. 204; *United States* v. *Chase*, 135 U. S. 255; *Hellmich* v. *Hellman*, 276 U. S. 233), Section 117 (f) controls if there was a retirement of the bonds, even though Section 23 (k) might otherwise be applicable. The regulations interpreting Section 23 (k) cannot bring and were not intended to bring within the operation of the general provisions of that section transactions which come under Section 117 (f).

There are no Treasury Regulations construing Section 117 (f) itself.[10] Article 117–4 (Appendix, *infra,* p. 37), which relates to the application of Section 117 generally, does not contain any reference to Section 117 (f) and merely provides that since the section relates to gains and losses from the sale or exchange of capital assets, it does not apply to losses sustained as the result of stock or debts becoming worthless. Insofar as the limitation may be said to refer to corporate bonds, it clearly refers to a situation where the bonds have not been disposed of but have become worthless.

There is a suggestion in the opinion of the court below that the bad-debt provisions rather than the loss provisions apply for the reason that the amount received, ½ of 1% of the face value of the obligations, was very small. But if Section 117 (f) applies to any case where bonds are discharged in a receivership by the payment of cash, it must apply to all such cases. The provision requires that "amounts received by the holder" upon the retirement of bonds and other evidences of indebtedness issued by a corporation shall be considered as amounts received in exchange therefor; therefore, if any amount is received, however small, it comes within the literal language of the statute.

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[10] There are also no regulations interpreting Section 117 (f) of the Revenue Acts of 1936 and 1938, and there are very few Bureau rulings in point. See I. T. 2986, XV–1 Cum. Bull. 136; I. T. 3121, 1937–2 Cum. Bull. 138.

Cf. *White* v. *United States*, 305 U. S. 281; *Powell* v. *Kyle* (E. D. Pa.), decided February 10, 1938, not officially reported, but may be found in 1938 C. C. H., Vol. 4, ¶ 9104. But even if it should be held that the capital-loss provisions do not apply where a purely nominal amount was received, we do not believe that the sum received here, $125, is such an amount.

It may also be argued that to permit a bondholder or debenture holder who receives nothing in a receivership proceeding to claim a bad-debt deduction and to deny a similar deduction to one that realizes a small fraction of his principal is unreasonable and inequitable and that for that reason Section 117 (f) should be held not to apply to this case. But Section 117 (f) is clear and an exception may not be engrafted on its unambiguous language. Cf. *Crooks* v. *Harrelson*, 282 U. S. 55.

A somewhat analogous situation was presented in *Echols* v. *Commissioner*, 61 F. (2d) 191 (C. C. A. 8th), which involved the question whether a stockholder who had received no distribution in the liquidation of a bankrupt corporation was entitled to treat the loss on his investment as a capital loss under Section 208 of the Revenue Act of 1928. Section 201 (c) of that Act provided that amounts distributed in complete or partial liquidation from a corporation should be treated as a payment in exchange for the stock. The taxpayers argued that to construe this statute as meaning that a

stockholder who realized some minute amount in liquidation had sustained a capital loss and that a stockholder who had received nothing had not was to reach an absurd result and consequently that the statute should be construed to include both transactions. But the court rejected that argument, holding that the language was unambiguous and that it did not cover a case where no amounts were received. See also *White* v. *United States*, 305 U. S. 281.

Conversely in this case Section 117 (f) applies to all amounts received by the holder of securities upon their retirement, without making any exception with respect to small payments, and the fact that the capital loss provisions would not apply if no amount had been received does not justify the holding that they do not apply where the amount received was small.

We submit, therefore, that there was a "retirement" of the taxpayer's debentures within the meaning of Section 117 (f) and, hence, that the resulting loss is a capital loss subject to the limitations of Section 117 (d).

If, however, the Court should hold that the case is one for a bad-debt deduction under Section 23 (k), we call attention to the fact that the Board made no findings of fact as to whether or not the debt was ascertained to be worthless and charged off during the taxable year. In the absence of such findings, it cannot be assumed that a deduction is

allowable under that section and, as the court below held, the case should be remanded to the Board for further findings.

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

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OCTOBER 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

(k) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * * *

(U. S. C., Title 26, Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

(f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. (U. S. C., Title 26, Sec. 101.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (k)-4. *Worthless bonds and similar obligations.*—Bonds, if ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations can not deduct from gross income any amount merely on account of market fluctuation. If a taxpayer ascertains, however, that due, for instance, to the financial condition of the debtor, or conditions other than market fluctuation, he will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and so demonstrates to the satisfaction of the Commissioner, he may deduct in computing net income the uncol-

lectible part of the debt evidenced by the bonds or other similar obligations.

* * * * *

ART. 117–4. *Application of section 117 generally.*—Section 117 applies only to gains and losses upon the sale or exchange of capital assets and, therefore, has no application to loss of useful value upon the permanent abandonment of the use of property (see article 23 (e)–3), or loss sustained as the result of corporate stock or debts becoming worthless.

* * * * *

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No. [redacted] 58

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

S. C. THOMSON,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Brief for Respondent in Opposition to Petition for Writ of Certiorari.

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No. 946.

IN THE

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October Term, 1939.

GUY T. HELVERING, Commissioner of Internal Revenue,
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v.
S. C. THOMSON,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Brief for Respondent in Opposition to Petition for Writ of Certiorari.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 10-15) is reported at 40 B. T. A. 60. The opinion of the Circuit Court of Appeals (R. 72) is reported in 108 F. (2d) 642.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered January 25, 1940 (R. 74). On April 25, 1940, petitioner filed a petition for writ of certiorari, invoking the jurisdiction of this Court under Section 240 (a) of the Judicial Code as amended.

Statement of Case.

In May, 1927, respondent, taxpayer, at a cost of $24,750 purchased $25,000 face amount of New York United Hotels, Inc., 20 year 6% sinking fund gold debentures maturing February 1, 1947 (R. 23). The debtor was organized to lease and operate the Roosevelt Hotel in New York City (R. 28). Its assets consisted of the lease, and the furnishings and equipment of the hotel (R. 28, 32). In 1931 the debtor encountered financial difficulties as a result of which the debenture holders agreed to postpone payment of certain of their interest coupons until the maturity of the debentures and to waive the payment of a portion of the sinking fund installments required under the indenture (R. 28-30). On December 15, 1933 ancillary receivers were appointed by the United States District Court for the Southern District of New York (R. 24).

A plan of reorganization (R. 34-42) was submitted to the Court by a reorganization committee, under which a new corporation was to be formed to purchase all the assets of the debtor and either negotiate a new lease with the lessor or obtain an assignment of the existing lease with important modifications; the new corporation was to issue debentures, preferred and common stock; and substantially all the new debentures ($1,205,000) were to go to the lessor in satisfaction of the debtor's indebtedness to it (R. 41). The plan offered to respondent and other debenture holders of the debtor the choice of acquiring stock of the new company in exchange for the old debentures, or of acquiring both debentures and stock of the new company in exchange for the old debentures plus a cash payment (R. 40).

This plan was approved by Judge Coxe in the District Court (R. 47-55) and by final order of May 22, 1934 (R. 58-62), Judge Coxe directed, among other things, that debenture holders and other creditors of the debtor not participating in the plan should be entitled to be paid

out of the cash balance in the hands of the receivers the sum of $5 per $1,000 face value of debentures or other claims upon surrender of the debentures or assignment of the claims on or before August 20, 1934 (R. 62).

Pursuant to Judge Coxe's final order respondent surrendered his debentures on June 22, 1934, and received a payment of $125 (R. 25).

Subsequently the action taken by the District Court was appealed by a debenture holder to the Circuit Court of Appeals for the Second Circuit, and there affirmed (*Rockwell v. New York United Hotels, Inc.* [1935], 79 F. [2nd] 81).

Questions Presented.

In his income tax return for 1934 respondent deducted from his gross income as a bad debt under Section 23 (k) of the Revenue Act of 1934 his loss of $24,625 on the New York United Hotels, Inc., debentures. Petitioner, Commissioner of Internal Revenue, disallowed the deduction, holding that the $125 payment made to respondent under order of Judge Coxe constituted "an amount received upon the retirement" of the debentures, within the meaning of Section 117 (f) of the Revenue Act of 1934; and that consequently respondent's loss became a loss from an exchange of capital assets within the meaning and subject to the limitations of Section 117 (d) of the same act. The Board of Tax Appeals affirmed petitioner and the Circuit Court of Appeals for the Second Circuit reversed.

The question at issue was whether the phrase "amounts received upon the retirement of corporate bonds" as used in Section 117 (f) of the Revenue Act of 1934, covers the payment made to respondent by the receiver under order of Judge Coxe. The Circuit Court of Appeals held that what happened with respect to the New York United Hotels, Inc., bonds may not fairly be taken as re-

tirement of the bonds because the word "retirement" signifies some voluntary action on the debtor's part in fulfillment of his promise to pay—action which was not present in the case at bar (R. 73).

Petitioner claims that the transaction shown by the record constituted a "retirement" of the bonds within the meaning of Section 117 (f) of the Revenue Act; and that the decision below is in substantial conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in *McClain v. Commissioner,* decided March 23, 1940 (not yet officially reported but published in Vol. 4, Prentice Hall, Federal Tax Service, 1940, par. 62, 518).

Argument.

The statement given in the petition herein shows on its face that there is no conflict between the decision in this case and the decision in the *McClain* case. The two sets of facts are as different as positive and negative; and the two decisions, taken together, define clearly what is and what is not a "retirement" within the meaning of Section 117 (f) of the Revenue Act.

In the *McClain* case the debtor paid off its bonds at approximately fifty cents on the dollar out of a Reconstruction Finance Corporation loan without receivership or bankruptcy and thereafter continued its existence and activities. That was obviously a "retirement" of the bonds because they were voluntarily taken back by the debtor itself.

But in the case at bar the debtor went out of business and existence, its assets were taken over by receivers in insolvency proceedings and were sold by them, and the proceeds—a mere one-half cent on the dollar—were distributed among bondholders and other creditors. That was obviously not a "retirement" of the bonds because they were not taken back by the debtor but were simply extinguished by a first and final liquidation dividend out

of the proceeds of sale of the defunct debtor's assets effected by receivers appointed by the Court for the benefit of creditors.

The so-called plan of reorganization in the case at bar (Petition, p. 3) was not for the reorganization of the debtor but was merely a plan under which bondholders of the debtor might, if they so desired, acquire bonds and stock of the new corporation (which had bought the assets from the receivers) by turning in their bonds to the new corporation and paying cash in addition.

The asserted "conflict" between the decision in the case at bar and the decision in the *McClain* case rests upon nothing more than that in both cases the Commissioner claimed a "retirement" and that in the case at bar the Court properly decided in favor of the taxpayer, while in the *McClain* case the Court properly decided in favor of the Commissioner. In other words, there is no conflict between the decisions but merely a fundamental difference between the two sets of facts. And such a difference, it is submitted, furnishes no basis for invoking the jurisdiction of this Court under Section 240 (a) of the Judicial Code.

Wherefore it is respectfully submitted that the application for a writ of certiorari should be denied.

T. F. DAVIES HAINES,
Respondent's Counsel.

May, 1940.

Appendix.

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

(k) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * *

[U. S. C., Title 26, Sec. 23.]

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

(f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. [U. S. C., Title 26, Sec. 101.]

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No. 58

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

S. C. THOMSON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT.

T. F. DAVIES HAINES,
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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
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v.

S. C. THOMSON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT

Opinions Below

The opinion of the United States Board of Tax Appeals (R. 6-9) is reported in 40 B. T. A. 60. The opinion of the Circuit Court of Appeals (R. 40-41) is reported in 108 F. (2d) 642.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered January 25, 1940 (R. 41-42). The petition for a writ of certiorari was filed April 25, 1940, and was granted May 20, 1940 (R. 42). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Statement of the Case

In his income tax return for 1934 the respondent claimed a deduction of $24,625 for a bad debt under Section 23(k) of the Revenue Act of 1934 (R. 7). The Commissioner disallowed the deduction on the ground that the transaction should be considered an exchange under Section 117(f) of the Revenue Act of 1934 and determined a deficiency in the tax (R. 4). The Board of Tax Appeals sustained the Commissioner (R. 5-9). The Circuit Court of Appeals unanimously reversed the Board and held that the transaction was not an exchange under Section 117(f) but a bad debt under Section 23(k) (R. 39-42).

The respondent purchased in May, 1927, $25,000 face amount of New York United Hotels, Inc. debentures maturing February 1, 1947 at a cost of $24,750 (R. 13). The debtor was a corporation organized to lease and operate the Roosevelt Hotel in New York City (R. 16). Its assets consisted of the lease and the furnishings and equipment of the hotel (R. 18).

On December 15, 1933 receivers were appointed for the debtor corporation by the United States District Court for the Southern District of New York (R. 13).

A plan of reorganization was submitted to the court under which a new corporation was to be formed to purchase all the assets of the debtor and either negotiate a new lease with the lessor or obtain an assignment of the existing lease with modifications (R. 15-24). The new corporation was to issue debentures, preferred and common stock; and substantially all of the new debentures ($1,205,000) were to go to the lessor in satisfaction of the debtor's indebtedness to it under the lease (R. 24).

The holders of the old debentures were given a choice of (1) acquiring common stock of the new company in exchange for old debentures in the ratio of 2½ shares of stock for each $1,000 debenture (R. 23), or (2) acquiring new debentures and preferred and common stock of the new company in

exchange for the old debentures plus a cash payment equal to the par value of the new debentures so acquired (R. 23).

General creditors of the debtor corporation were offered 2½ shares of common stock of the new company for each $1,000 of indebtedness (R. 22). Thus the old debenture holders who did not wish to put fresh money into the new company were treated in the same fashion as general creditors.

This plan was approved by the District Court (R. 27-32), but by final order of May 22, 1934 (R. 33-36) the court directed that debenture holders and other creditors of the debtor not participating in the plan should be paid out of the cash balance in the hands of the Receivers the sum of $5.00 per each $1,000 face value of debentures or creditors' claims, such payment to be made upon surrender of the debentures or assignment of the claims within 90 days of the order (R. 36). To carry out the terms of its order affecting the non-participating debenture holders and creditors, the court ordered that the receivers turn over the balance of cash and accounts receivable in their hands to the lessor of the debtor on condition that the lessor pay therefrom to the new company the amount necessary to enable the new company to pay certain past due franchise taxes and the non-participating debenture holders and other creditors (R. 35-36). In this way the receivers were discharged upon the transfer of the receivership balances to the lessor.

The respondent refused to participate in the reorganization plan, surrendered his debentures on June 22, 1934 and received a payment of $125 (R. 14) representing a dividend of ½ of 1¢ on the dollar. This payment corresponded to the liquidating dividend paid to other non-participating creditors of the debtor.

The plan of reorganization was objected to by certain of the debenture holders, who appealed from the final order to the Circuit Court of Appeals for the Second Circuit. The Circuit Court affirmed the District Court in *Rockwell* v. *New York United Hotels*, 79 F. (2d) 81, certiorari denied, *sub nom, Donahue* v. *Rockwell*, 296 U. S. 650.

The question on this appeal is whether the payment to the respondent of the liquidating dividend of $125 on his debentures having a face value of $25,000 and for which he had paid $24,750 resulted in a bad debt deductible under Section 23(k) of the Revenue Act of 1934, or whether the payment can fairly and properly be said to constitute a "retirement" of the debentures within the meaning of Section 117(f).

Summary of Argument

I. The respondent's loss on his debentures constituted a bad debt within the meaning of Section 23(k) of the Revenue Act of 1934. The debentures constituted a "debt" within the meaning of Section 23(k). The payment of the first and final dividend on the debentures of $5 per $1,000 in the receivership proceedings proved their worthlessness.

Section 23(k) of the Act and the corresponding Regulation, Article 23(k) of Regulations 86, specifically cover the respondent's loss without in any way straining the language contained therein. Section 117(f) of the Act which covers the "retirement" of bonds could only be made to apply by giving a strained and unusual meaning to the word "retirement".

II. Section 117(f) of the Revenue Act of 1934 relating to the "retirement of bonds" has no application to the respondent's loss. "Retirement" as used in Section 117(f) must be given its common and ordinary meaning, which is a "payment" of "withdrawal from circulation" of the debtor's obligations by some voluntary act of the debtor. It does not mean an involuntary extinguishment of the obligations by the payment of a nominal dividend in insolvency proceedings.

The fact that Section 117(f) uses the word "retirement" rather than the word "redemption" does not indicate that Congress intended "retirement" to cover an extinguishment

of an obligation in insolvency proceedings. "Retirement" may have a broader meaning than "redemption", but both words imply that the debtor effecting the "redemption" or "retirement" be a free agent or acting entity.

There is no indication that Congress intended to classify a loss like the respondent's as a capital loss rather than as a bad debt. Had Congress had such an intention it would have accomplished it by an amendment to Section 23(k), which Congress in fact did in the Revenue Act of 1938.

ARGUMENT

I

The payment of the first and final liquidating dividend of one-half of one per cent on the debentures made them a debt worthless in part, the uncollectible portion of which was deductible as a bad debt under Section 23(k) of the Revenue Act of 1934.

The Revenue Act of 1934 made a clear distinction between two different types of losses sustained by taxpayers on bonds and similar securities. The first type of loss was that resulting from debts "ascertained to be worthless" or "recoverable only in part", was covered by Section 23(k) of the Act* and could be entirely deducted from gross income. The second type of loss was that resulting from "the sale or exchange of a capital asset", was covered by Section 117 of the Act and could be deducted only to the extent of $2,000 plus the gains from such sales or exchanges. Section 117(f) provided in effect that losses resulting from a retirement of bonds, practically speaking a purchase of the bonds by the debtor, should be treated in the same way as a loss resulting from a sale to a third party.

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* The pertinent provisions of all statutes and regulations involved will be found in the Appendix, *infra*, pp. 14-18.

The respondent's loss in the instant case was a loss of the first type expressly covered by Section 23(k) of the Act.

The respondent's debentures were clearly evidences of debt. The Treasury Department treated "bonds of an insolvent corporation" as bad debts deductible under Section 23(k) (Article 23(k)-4 of Regulations 86, Appendix, *infra*, p. 18). And the Government concedes, as it must, that bonds have been treated as debts within the meaning of the bad debt provisions of the Revenue Act of 1934 and previous statutes (Brief, p. 27).

It is equally clear that the first and only dividend received by the respondent on the debentures in the insolvency proceedings, amounting to one-half of one per cent of his investment and paid out of the available funds left in the hands of the receivers, demonstrated their partial worthlessness. Article 23(k)-2 specifically mentions as an example of a bad debt "the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim".

Consequently the Circuit of Appeals correctly held that "the case was one of bad debt" (R. 41).

The Government's argument that the respondent's loss is covered, not by Section 23(k) of the Act, but rather by Section 117(f), is contained in subsection 5 of its brief, at pages 26-30. The substance of the argument is that Section 117(f) "deals specifically with the retirement of bonds", that it is a "well-established rule of construction that a specific provision prevails over a general provision", so that "Section 117(f) controls if there was a retirement of the bonds, even though Section 23(k) might otherwise be applicable" (Brief, p. 29). In other words, the Government admits that Section 23(k) covers the loss here involved, but maintains that Section 117(f) covers it more specifically.

The answer is that Section 23(k) and the corresponding article of the Regulations apply exactly to the respondent's loss without in any way straining the language therein contained. But in order to make Section 117(f) apply, a distorted and unusual meaning must be given to the language therein used.

Section 23(k) covers "debts ascertained to be worthless" and "recoverable only in part". A debt extinguished by the payment of a small dividend in a receivership proceeding is just such a debt.

Article 23(k)-1 of the Regulations provides that "bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt". The Government's statement (Brief, p. 27) that "the above regulation appears to be applicable only to unsecured and unpreferred debts" is concededly correct. But that fact does not make the provision inapplicable to this case, for the respondent's debentures were "unsecured and unpreferred" debts of New York United Hotels, Inc. (See *Rockwell* v. *New York United Hotels*, 79 F. (2d) 81, *supra*).

Article 23(k)-2, which the Government's brief does not mention, specifically gives as an example of a bad debt coming within the provisions of Section 23(k) "the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim."

Article 23(k)-3 covers the "uncollectible deficiency upon sale of mortgaged or pledged property". As the respondent's debentures were unsecured this article has no application.

Article 23(k)-4 states that "bonds, if ascertained to be worthless, may be treated as bad debts to the amount actually paid for them". This article thus exactly covers the case at bar. The Government's only comment is (1) that the article "may relate only to bonds which do not constitute capital assets as defined in Section 117" and (2) that "probably it was intended to govern obligations not otherwise removed from the operation of the bad-debt

provisions by such specific provisions relating to capital losses as are contained in Section 117" (Brief, p. 28). The first comment is without support in either the statute or the Regulations, for nothing in either suggests that losses sustained by virtue of capital assets becoming worthless may not be deducted as bad debts, and the contrary is of course the case (*Commonwealth Commercial State Bank* v. *Lucas*, 41 F. (2d) 111 (C. A. D. C.); *Pacific National Bank of Seattle* v. *Commissioner*, 91 F. (2d) 103 (C. C. A. 9); *Huntting* v. *Commissioner*, 32 B. T. A. 495; *Corbett* v. *Commissioner*, 15 B. T. A. 698). The second comment would only be material if the respondent's loss were covered by Section 117.

The provisions of Section 117, however, only apply if the extinguishment of the obligation represented by the debentures in the receivership proceedings constituted a "retirement" of the bonds under Section 117(f). Section 117 would not apply if the transaction did not constitute a "retirement" but merely rendered the obligation totally or partially worthless (Regulations 86, Art. 117-4, Appendix, *infra*, p. 18). In the following point it is shown that only by giving the word "retirement" the most distorted and unusual meaning can it be made to apply to the transaction involved in this case.

II

Section 117(f) of the Revenue Act of 1934 relating to the "retirement of bonds" has no application to the respondent's loss.

The Government concedes (Brief, p. 11) that in the absence of Section 117(f) of the Revenue Act of 1934 this transaction would not be a sale or exchange within the meaning of Section 117(d). Section 117(f) provides as follows:

> "(f) *Retirement of bonds, etc.*—For the purposes of this title, amounts received by the holder upon the

retirement of bonds, debentures, notes or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subsidiary thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

The question is, therefore, whether or not the payment by the receivers of the debtor corporation of one-half of one per cent on the respondent's debentures constituted a "retirement" of the debentures within the meaning of the statute.

The Government points out (Brief, p. 12) that, as the word "retirement" has no established legal meaning, it must, under the rules of construction consistently followed by this Court, be given its common and ordinary meaning. The Government then quotes (Brief, p. 13) two dictionary definitions of "retire": the first, that it means "to withdraw from circulation, or from the market; to take up or pay"; the second, that it means "to recover; redeem; regain by the payment of a sum of money". Clearly these words mean "withdraw from circulation", "take up", "pay" or "recover" by some voluntary act of the debtor. They do not cover the involuntary extinguishment of the debtor's obligation by the payment of a nominal dividend in insolvency proceedings.

The distinction is well brought out in the opinion of the Circuit Court of Appeals, in which the Court stated (R. 41):

> "Dictionary definitions of 'retire' are 'to pay up and withdraw from circulation', 'to withdraw from circulation or from the market', 'to take up or pay'. The word signifies some voluntary action on the debtor's part in fulfillment of his promise to pay. A man as sanguine as Micawber might describe his bankruptcy as a 'retirement' of his obligations, but a merchant seeking credit who spoke in such euphemisms might find himself in trouble later. Where creditors receive a petty dividend (one-half of one per cent in this case) on the collapse of their debtor, their claims may be extinguished but are hardly 'retired'."

The true meaning of "retirement" is also made plain in *Empire Security Co.* v. *Berry*, 211 Ill. App. 278, cited by the Government (Brief, p. 13) as approving one of the dictionary definitions of "retire". In that case the plaintiff was the holder of a promissory note and of a guaranty by a third party that the note would be "retired". The maker of the note defaulted and the plaintiff sued the guarantor. The court held that "retirement" meant "payment" and held for the plaintiff.

The citation by the Government of the *Berry* case shows the fallacy in its argument. If respondent in the instant case had held the guaranty of a third party to pay the debentures if they were not "retired", the Government could hardly argue that the guarantor's obligation would have been extinguished by the payment of one-half of one per cent on the debentures in the receivership proceedings.

The Government states (Brief, p. 13) that "as employed in its ordinary sense, the word 'retirement' is properly used to describe the transaction by which, in receivership or bankruptcy proceedings, the bondholders or debenture holders of a debtor corporation are required to surrender their bonds or debentures and accept cash payments in full satisfaction of their debt so that a reorganization may proceed". Even if the word "retirement" could be stretched to apply to a transaction such as that described by the Government, it would have no application to the present case. The respondent was not, as the Government suggests, "required to surrender" his debentures and accept a cash payment in satisfaction of his claim so that the reorganization could proceed. The respondent had nothing to do with the reorganization, but was simply one of a number of general creditors who refused to participate in the reorganization and who was therefore paid a dividend of one-half of one per cent out of the receivership assets. If he had chosen not to surrender

his debentures against the nominal liquidating dividend the reorganization would nevertheless have proceeded to a final conclusion, for the court order so provided (R. 35-36). And the same payment would necessarily have been made even if no reorganization had been contemplated.

There were open to the respondent the following three alternative courses:

(a) To participate in the plan by surrendering his debentures to the new company (with or without a cash payment) in exchange for securities of the new company;

(b) To proceed under the court's final order by surrendering his debentures within 90 days in exchange for a first and final liquidation payment of $5 per $1,000 debenture out of the cash balance in the hands of the receivers;

(c) To disregard both the plan and the order and to allow the debentures to become wholly worthless and a complete loss at the expiration of 90 days.

The respondent chose the second of these three alternatives. But suppose that he had chosen the third alternative. Would the Government have argued that his worthless debentures represented anything but a 100% loss on a bad debt? And if not, what difference can it make that the respondent took the trouble to salvage at least one-half of one cent on the dollar in the form of a sole and final liquidation dividend out of the meager funds left in the hands of the receivers?

The Government's discussion (Brief, pp. 14-16) of the relative meanings of "redemption" and "retirement" is beside the point. Of course, "retirement" includes and is broader than "redemption", but both words have the prefix "re" meaning "back" and consequently both words apply only to a "withdrawal from circulation" when made by the debtor itself. If the debtor pays off and retires its

bonds in accordance with their terms, the transaction is admittedly a "redemption" and the bonds may be said to have been both "redeemed" and "retired". If the debtor solicits and obtains tenders of its bonds from the bondholders at some price less than the redemption price, the transaction can be fairly termed a "retirement" of the bonds, but not a "redemption". To that extent "retirement" is broader than redemption. But in the use of both terms it is implicit that the debtor effecting the "redemption" or "retirement" be still a free agent or acting entity and that he continue so after the bonds have been redeemed or retired.

In view of the clear and unambignous language of the statute, there is no relevancy in the Government's discussion (Brief, pp. 19-26) of the legislative history as disclosing the intention of the Congress in enacting Section 117(f) of the Revenue Act of 1934 (*Standard Fashion Co.* v. *Magrane-Houston Co.*, 258 U. S. 346, 356). Let it be granted that the legislative intent was to classify as a capital gain or loss any gain or loss resulting from a "retirement" of corporate obligations. What happened in the case at bar cannot possibly be considered a "retirement" in any grammatical or legal sense for the reasons already given, at least unless the wording of Section 117(f) discloses an intent to extend the meaning of "retirement" so far beyond its normal limits as to include a surrender of corporate bonds against payment of a final liquidating dividend out of receivers' funds. But nothing in either the wording or context of Section 117(f) suggests such an intent. On the contrary, Regulations 86 under the Revenue Act of 1934 (approved by the Secretary of the Treasury on February 11, 1935), provide as follows at Article 117-4:

> "*Application of Section 117 generally*—Section 117 applies only to gains and losses upon the sale or exchange of capital assets and, therefore, has no application to loss of useful value upon the

permanent abandonment of the use of property (see Article 23 [e]-3) or loss sustained as a result of corporate stock or debts becoming worthless."

Had it been intended to classify a loss like respondent's as a capital loss rather than a bad debt the Congress would have found no difficulty in saying so in plain language, and by amendment to Section 23(k) which deals with bad debts. In fact, the Congress did exactly that in 1938 (Revenue Act of 1938, Section 23(k), Appendix, *infra*, p. 15).

There is no mystery about the purpose of Section 117(f). The Courts had previously held that a *redemption* of bonds *before maturity* by the *issuing corporation* could not be treated as a sale or exchange of capital assets within the commonly accepted meaning of the words. *Fairbanks* v. *U. S.*, 95 F. (2) 794, aff'd 306 U. S. 436; *Watson* v. *Commissioner*, 27 B. T. A. 463. So the Congress enacted Section 117(f) to nullify the effect of these decisions and to classify any kind of voluntary retirement by the issuing corporation before maturity as a sale or exchange of capital assets. But in making this change in Section 117 the Congress had no intention of amending the provisions of Section 23(k) which applied to bonds ascertained to be worthless as the result of the insolvency of the issuing corporation.

CONCLUSION

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

T. F. DAVIES HAINES,
Attorney for Respondent.

APPENDIX

Revenue Act of 1934, May 10, 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(k) *Bad debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of capital assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * * * *

(d) *Limitation on capital losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * * * *

(f) *Retirement of bonds, etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

* * * * * * *

Revenue Act of 1938, May 28, 1938, c. 289, 52 Stat. 447:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(k) *Bad debts.*—

(1) GENERAL RULE.—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. This paragraph shall not apply in

the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection.

(2) SECURITIES BECOMING WORTHLESS.—If any securities (as defined in paragraph (3) of this subsection) are ascertained to be worthless and charged off within the taxable year and are capital assets, the loss resulting therefrom shall, in the case of a taxpayer other than a bank, as defined in section 104, for the purposes of this title, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

(3) DEFINITION OF SECURITIES.—As used in this subsection the term "securities" means bonds, debentures, notes, or certificates, or other evidences of indebtedness, issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23(k)-1. *Bad debts.*—

* * * * * * *

Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases is sometimes possible before and at other times only when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year. If a taxpayer com-

putes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation.

* * * * * * *

ART. 23(k)-2. *Examples of bad debts.*—Worthless debts arising from unpaid wages, salaries, rents, and similar items of taxable income will not be allowed as a deduction unless the income such items represent has been included in the return of income for the year for which the deduction as a bad debt is sought to be made or for a previous year. Only the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim may be deducted as a bad debt. The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. A purchaser of accounts receivable which can not be collected and are consequently charged off the books as bad debts is entitled to deduct them, the amount of deduction to be based upon the price he paid for them and not upon their face value.

ART. 23(k)-3. *Uncollectible deficiency upon sale of mortgaged or pledged property.*—If mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, and charges it off, he may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it is ascertained to be wholly or partially worthless and charged off. In addition, if the creditor buys in the mortgaged or pledged property, loss or gain realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which

has been returned by him) and the fair market value of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

Accrued interest may be included as part of the deduction only if it has previously been returned as income.

ART. 23(k)-4. *Worthless bonds and similar obligations.*—Bonds, if ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations can not deduct from gross income any amount merely on account of market fluctuation. If a taxpayer ascertains, however, that due, for instance, to the financial condition of the debtor, or conditions other than market fluctuation, he will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and so demonstrates to the satisfaction of the Commissioner, he may deduct in computing net income the uncollectible part of the debt evidenced by the bonds or other similar obligations.

* * * * * * *

ART. 117-4. *Application of section 117 generally.*—Section 117 applies only to gains and losses upon the sale or exchange of capital assets and, therefore, has no application to loss of useful value upon the permanent abandonment of the use of property (see article 23(e)-3), or loss sustained as the result of corporate stock or debts becoming worthless.

* * * * * * * *

SUPREME COURT OF THE UNITED STATES.

Nos. 55, 58.—October Term, 1940.

Donald S. McClain, Petitioner, 55 *vs.* Commissioner of Internal Revenue.	On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.
Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 58 *vs.* Florence Stanton Thomson, Executrix Under the Will of S. C. Thomson, Deceased.	On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 6, 1941.]

Mr. Justice Roberts delivered the opinion of the Court.

These cases present the question whether upon the surrender of bonds or debentures in exchange for a money payment less than cost, a taxpayer may deduct the loss from his gross income as a bad debt under § 23(k)[1] or must treat it as a capital loss under § 117(f)[2] of the Revenue Act of 1934.

In number 55 it appears that the taxpayer owned $15,000 par value of bonds of a water district, acquired by gift. The district being in financial difficulties offered to pay $7,476.75 for them. The offer was accepted and the bonds delivered. In his tax return the taxpayer claimed a deduction of $7,523.25 as for a bad debt charged off. The Commissioner disallowed the deduction, and the Board of Tax Appeals and the Circuit Court of Appeals[3] sustained his ruling.

In number 58 the facts are that the taxpayer bought $25,000 par value of debentures for $24,750. The issuer's affairs were placed in the hands of a receiver. A plan of reorganization provided that

[1] 48 Stat. 689; 26 U. S. C. § 23(k).
[2] 48 Stat. 715; 26 U. S. C. § 117(f)
[3] 110 F. (2d) 878.

the receiver should pay $5.00 for each $1000 debenture surrendered for cancellation. The taxpayer availed himself of this provision, and in his tax return claimed a deduction of $24,625, as for a bad debt. The Commissioner disallowed the claim, and the Board of Tax Appeals affirmed his decision. The Circuit Court of Appeals reversed.[4]

By reason of the conflict of decision we granted certiorari in both cases.

The earlier revenue acts contained sections similar to 23(k) of the Act of 1934. They also embodied provisions for calculation of taxes on capital net gains. None of them included any section like 117(f). Prior to the adoption of the 1934 Act it had been held that the phrase "sale or exchange" of capital assets, employed in those Acts, was not descriptive of the redemption or call for repayment of corporate securities, and hence gain thereby occasioned was to be treated as ordinary income[5], and loss so arising was to be deducted from gross income as a bad debt.[6]

The Revenue Act of 1934, by sub-section (f) of § 117, provided that for the purposes of the title dealing with capital gains and losses, "amounts received by the holder upon the retirement" of such securities as are here involved, "shall be considered as amounts received in exchange therefor".

It is plain that Congress intended by the new sub-section (f) to take out of the bad debt provision certain transactions and to place them in the category of capital gains and losses. The question is whether by employing the word "retirement" the transactions here involved were so transferred. We hold that they were.

"Retirement" aptly describes what occurred in the instant cases. The statute does not use the word in an unusual or artificial sense. In common understanding and according to dictionary definition the word "retirement" is broader in scope than "redemption"; is not, as contended, synonymous with the latter, but includes it. Nothing in the legislative history of the provision requires us to

[4] 108 F. (2d) 642.

[5] Watson *v.* Commissioner, 27 B. T. A. 463; Braun *v.* Commissioner, 29 B. T. A. 1161. This view was adopted by this court as respects the Revenue Act of 1928, subsequent to the adoption of the Act of 1934. Fairbanks *v.* United States, 306 U. S. 436.

[6] Commonwealth Bank *v.* Lucas, 41 F. (2d) 111; Lebanon Nat. Bank *v.* Commissioner, 76 F. (2d) 792; Pacific Nat. Bank *v.* Commissioner, 91 F. (2d) 103.